



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 29

Australian market licences: Australian operators

November 2001

Your comments

You are invited to comment on the proposals and issues for consideration in this paper.

Comments are due by Friday, 30 November 2001 and should be sent to:

**Roxanna Irvin
FSR Project Office
Regulatory Policy Branch
Australian Securities & Investments Commission
GPO Box 4866
Sydney NSW 1042
email: FSRProjectOffice@asic.gov.au**

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

What this policy proposal is about

1 This policy proposal paper outlines ASIC’s role in, and proposed approach to, financial market regulation under the *Financial Services Reform Act 2001* (FSR Act). It deals with financial markets operating in Australia, except for the overseas markets referred to in s795B(2).

2 It covers our approach to the following issues:

- (a) our role in market regulation (**Section A**);
- (b) what “operate a financial market” means (**Section B**);
- (c) what “operate a financial market in Australia” means (**Section C**);
- (d) exemptions from market regulation (**Section D**);
- (e) obligations of Australian market licensees (**Section E**); and
- (f) how to obtain an Australian market licence (**Section F**).

3 The **Schedule** gives examples of types of activities that will require an Australian market licence.

4 The proposals in this paper are based on the FSR Act, including the *Corporations Amendment Regulations 2001 (No 4)* (regulations).

5 From FSR commencement, Policy Statement 100 *Stock markets* [PS 100] and Policy Statement 70 *Exempt futures markets* [PS 70] will be replaced by a new policy statement incorporating:

- (a) the proposals in this paper;
- (b) amendments required following the making of any further regulations; and
- (c) comments received from the consultation process.

Important note: The proposals in this paper do not constitute legal advice. Potential market licensees should seek their own legal advice. The policy and examples in this paper are at a preliminary stage only. There may be changes as a result of the comments we receive. This paper should be treated as an indication of how we are thinking at this stage.

Contents

What this policy proposal is about	3
Policy proposals.....	5
A Our role in financial market regulation.....	6
B Do you operate a financial market?.....	12
C Do you operate a financial market in Australia?	19
D What is our approach to exemptions?	24
E Obligations of market licensees	29
F How do you obtain an Australian market licence?	50
Schedule: What types of activities will require an Australian market licence?	63
Regulatory and financial impact	71
Development of policy proposal	73
Key terms.....	75
What will happen next?.....	77
Related papers.....	78
To find out more about FSR	80

Policy proposals

In this paper, there are six areas of policy proposals for Australian market licences. For each area, we set out the proposals and identify issues we would like you to comment on. When necessary we have also included explanations of our proposals.

Special note: We want to provide guidance about our plans for policy and processes. While we have covered most of the main issues, potential market licensees will need to make their own preparation plans. There may be other issues that you consider important. *We are keen to hear from you on our general approach, and what other issues you consider important, as well as your answers to specific questions.*

A Our role in financial market regulation

Policy proposal	Your feedback
<p>ASIC’s role</p> <p>A1 The Minister has the main responsibility for regulating financial markets operating in Australia.</p> <p>A2 ASIC’s role in regulating financial markets is to:</p> <ul style="list-style-type: none"> (a) advise the Minister about applications for a market licence, changes to operating rules, other matters in respect of which the Minister has a discretion under Part 7.2 of the FSR Act and other matters concerning financial markets; (b) assess and report to the Minister on market licensees’ compliance with their obligations; (c) enforce market licensees’ compliance with their obligations; and (d) enforce the prohibition on a person operating, or holding out that the person operates, a financial market in Australia, if the person does not hold a licence or an exemption. <p>Our approach to this role</p> <p>A3 Whenever we perform the roles referred to in policy proposal paragraph A2, we will have regard to:</p> <ul style="list-style-type: none"> (a) the purposes of market regulation: see policy proposal paragraph A4; and (b) the need to apply the regulatory regime flexibly, according to the features of the market in question: see policy proposal paragraph A6. 	

Policy proposal	Your feedback
<p>A4 The purposes of market regulation are to:</p> <ul style="list-style-type: none">(a) protect market users; and(b) enhance market integrity and financial system stability.	<p>A4Q1 Does financial market regulation serve any other public policy purposes we should take into account?</p>
<p>A5 Market regulation achieves these purposes by requiring market operators to be licensed and to achieve key outcomes in the main regulatory areas. In Table A, we set out:</p> <ul style="list-style-type: none">(a) the main regulatory areas;(b) the key outcomes; and(c) the main mechanisms the regulatory regime uses to achieve these outcomes.	<p>A5Q1 Have we correctly described the key outcomes of market regulation?</p> <p>A5Q2 Are there any key outcomes that we have not identified? If so, please identify any additional areas or the nature of those outcomes.</p>
<p>A6 The methods by which market operators achieve the key outcomes will vary according to:</p> <ul style="list-style-type: none">(a) the way the market operates;(b) the nature of the products traded on it; and(c) the types of market users and participants, <p>and therefore the regulatory regime must be applied flexibly.</p>	<p>A6Q1 Are there other variables that affect achieving the key outcomes for a financial market?</p>

Table A: Regulatory outcomes and mechanisms in financial markets

Regulatory area	Key outcomes	Market regulatory mechanisms*
Market information	<p>Market users use the market on an informed basis. For example:</p> <ul style="list-style-type: none"> • information about the market operator, market processes, listed entities, product issuers and products traded is adequate and accurate • information is made available in a timely way • information is available to all users and potential users • listed entities comply with the market’s operating rules about disclosure 	<p>The market operator must:</p> <ul style="list-style-type: none"> • ensure that the market is fair, orderly and transparent • enforce compliance with market operating rules • notify ASIC of suspected breaches of the law or the market’s operating rules by listed entities
Trading	<p>Market users are confident that the market as a whole operates fairly and that they will be treated fairly. For example:</p> <ul style="list-style-type: none"> • bids and offers are open to all participants • the methods by which bids and offers are matched are fair • most trading takes place on market through the main market facility • the market is not vulnerable to price manipulation or other abusive trading conduct 	<p>The market operator must:</p> <ul style="list-style-type: none"> • ensure that the market is fair, orderly and transparent • supervise the conduct of participants on or in relation to its market and enforce compliance with market operating rules • notify ASIC of suspected breaches of the law or the market’s operating rules by any person
Participants	<p>Market users and the public generally are confident about the participants they deal with. For example, participants:</p> <ul style="list-style-type: none"> • provide adequate advice to clients, comply properly with instructions, and properly complete transactions • protect their clients’ interests adequately and do not act in their own interests to the detriment of their clients 	<p>The market operator must:</p> <ul style="list-style-type: none"> • ensure that the market is fair, orderly and transparent • supervise the conduct of participants on or in relation to its market • notify ASIC of disciplinary action against a participant, suspected breaches of the law or the market’s

Regulatory area	Key outcomes	Market regulatory mechanisms*
	<ul style="list-style-type: none"> • do not misappropriate client money or other property in connection with trading on the market • comply with the law and the market’s operating rules • are financially sound, so that clients do not risk losing trading opportunities, money or other property, and clients and the participant’s counterparties are able to settle market transactions 	<ul style="list-style-type: none"> operating rules by a participant or the inability of a participant to meet obligations as a financial services licensee • have appropriate compensation arrangements protecting client money and other property held by market participants
Market supervision	<p>Listed entities, participants and market users that breach the law or market operating rules are likely to be detected and disciplined, and as a result:</p> <ul style="list-style-type: none"> • participants and existing and potential market users have confidence in the market • participants and market users are not disadvantaged, for example, by losing trading opportunities or best prices • the market has a good reputation <p>Market supervision is not compromised by:</p> <ul style="list-style-type: none"> • conflicts between the market operator’s duties and interests • the control of the market operator • the involvement of unfit individuals in the management of the market operator • the operator’s lack of resources 	<p>The market operator must</p> <ul style="list-style-type: none"> • ensure that the market is fair, orderly and transparent • have adequate arrangements for supervising the market and enforcing compliance with operating rules • have adequate resources to operate and supervise the market • provide information to ASIC to enable ASIC to monitor the market operator’s compliance with its obligations • have adequate arrangements for handling conflicts of interest • take reasonable steps to ensure an unacceptable control situation does not exist • take reasonable steps to ensure that no disqualified individual becomes or is involved in the market operator

Regulatory area	Key outcomes	Market regulatory mechanisms*
Market stability	<p>The market operates reliably, and is not at risk of failing, so that:</p> <ul style="list-style-type: none"> • existing and potential market users can be confident it will be available when they want to trade • operators of other markets or clearing and settlement facilities will not be adversely affected by any failure of the market <p>The price formation process operates reliably.</p>	<p>The market operator must:</p> <ul style="list-style-type: none"> • ensure that the market is fair, orderly and transparent • have sufficient financial, technological, human and other resources to operate the market properly
Clearing and settlement	<p>Transactions entered into on the market are settled promptly, fairly and effectively.</p>	<p>The market operator must:</p> <ul style="list-style-type: none"> • ensure that the market is fair, orderly and transparent • have adequate clearing and settlement arrangements and/or disclose the particulars of or absence of clearing and settlement arrangements to participants • supervise the conduct of participants on or in relation to its market

*Note: Australian market regulation achieves the key regulatory outcomes by requiring a market operator to be licensed and imposing the obligations, referred to in this column, on market licensees. Other regulatory mechanisms, such as ASIC's supervision of the market licensee's compliance with its obligations, Ministerial disallowance of changes to the operating rules of a market licensee and obligations imposed directly on financial services licensees, are also used to achieve the key outcomes.

Explanation

1 ASIC plays an important but secondary role in financial market regulation: see Revised Explanatory Memorandum, paragraph 7.4.

2 The main sources of ASIC's power to perform the role described in policy proposal paragraph A2 are s794A, 794C, 794D, 798B and 1315.

3 Our general approach to our role in financial market regulation focuses on the outcomes that the legislation seeks to achieve.

4 Our approach and our identification of the key outcomes achieved by financial market regulation do not differ significantly from Policy Statement 100 *Stock markets* [PS 100]. However, the FSR Act sets out the market regulatory mechanisms more explicitly than the old Corporations Act.

B Do you operate a financial market?

Policy proposal	Your feedback
<p>Our general approach</p> <p>B1 If there is uncertainty or ambiguity about whether the definition applies, we will interpret the definition of a financial market in s767A as applying only when it is necessary to achieve the regulatory outcomes identified in Table A.</p> <p>What is a financial market?</p> <p>Note: The following policy proposals set out our interpretation of key terms in the definition of a financial market. For the definition of a financial market, see explanation paragraph B3.</p> <p>What is a “facility”?</p> <p>B2 An integrated infrastructure constitutes a single facility and may be a financial market even if any or all of its component parts, when considered in isolation, do not constitute a financial market.</p> <p>B3 The following factors indicate that a number of component parts constitute an integrated infrastructure and a single facility:</p> <ul style="list-style-type: none"> (a) the component parts are owned or controlled by the same entity; or (b) together the component parts enable the making and/or acceptance of offers or invitations and no component part is a regulated market. 	<p>B1Q1 Are there examples where interpreting the definition against the regulatory outcomes would produce an undesirable result?</p> <p>B3Q1 Are there any other factors that indicate that a number of component parts constitute an integrated infrastructure?</p>

Policy proposal	Your feedback
<p>What does “through” mean?</p> <p>B4 A facility will not constitute a financial market merely because it is a step in the process that results in the eventual making or acceptance of offers or invitations. We read “through” in s767A(1) narrowly so that a facility only amounts to a financial market if the offers or invitations are made or accepted <i>by means of</i> or <i>on</i> the facility.</p>	<p>B4Q1 Does a narrow reading of “through” produce any anomalies in the way the law works, for example, by putting licensed market operators at a competitive disadvantage?</p> <p>B4Q2 Would such anomalies be cured by a broad reading of “through”, so that any form of facility instrumental in the eventual making or acceptance of offers or invitations constitutes a financial market?</p>
<p>What is an “offer” or an “invitation”?</p> <p>B5 We read the terms “offer” and “invitation” broadly, to include:</p> <ul style="list-style-type: none">(a) formal contractual offers;(b) requests for others to make a formal contractual offer; and(c) requests to enter a course of negotiations with a view to entering into a binding contract. <p>B6 An offer or an invitation will generally identify:</p> <ul style="list-style-type: none">(a) a person who is likely to acquire or dispose of a financial product or his or her agent; and(b) the price at which that person is likely to acquire or dispose of a financial product.	<p>B6Q1 Should we provide further guidance on the characteristics of an offer or invitation? If so, what should that guidance be?</p>

Policy proposal	Your feedback
<p><i>When and where is an offer or invitation made or accepted?</i></p> <p>B7 An offer or invitation is:</p> <ul style="list-style-type: none">(a) <i>made</i> when and where it is received by the person to whom the offer or invitation is made or their agent; and(b) <i>accepted</i> when and where the acceptance is received by the person who makes the offer or invitation or their agent.	<p>B7Q1 Are offers or invitations made or accepted at an earlier point in time, or at a different place?</p>
<p><i>What does “regularly” mean?</i></p> <p>B8 “Regularly” means systematically, in the sense that there are recurring opportunities to acquire or dispose of financial products through the facility. “Regularly” does not mean at specified intervals.</p>	<p>B8Q1 Do some facilities, that might otherwise be financial markets, fall outside the definition because the trading volumes on them are so small that trading on them is not “regular”?</p> <p>B8Q2 If so, what are the volume and other limits of such facilities?</p> <p>B8Q3 Alternatively, is it preferable to regard such facilities as financial markets, but recommend the Minister exempt them (see Section D)?</p>

Explanation

1 Under the FSR Act, you will need an Australian market licence if:

- (a) you operate a financial market;
- (b) you operate that market in Australia; and
- (c) the market which you operate has not been exempted from the operation of Part 7.2.

Section B of this policy proposal paper examines when a person operates a financial market by outlining the scope of the definition of “financial market”.

Our general approach

2 “Financial market” is defined in s767A in broad and flexible terms. When determining whether an activity falls within the scope of this definition we must have regard to the object and purpose of the market regulation provisions: see s15AA *Acts Interpretation Act 1901*. Accordingly, to the extent possible we will interpret the definition so that only activities that compromise the regulatory outcomes identified in Table A fall within its scope.

What is a financial market?

3 Section 767A(1) contains a general definition of a financial market. Our approach to the interpretation of the key terms in that definition is set out below. See also the Schedule: What types of activities will require an Australian market licence?

Note: Section 767A(1) provides:

For the purposes of this Chapter, a *financial market* is a facility through which:

- (a) offers to acquire or dispose of financial products are regularly made or accepted; or
- (b) offers or invitations are regularly made to acquire or dispose of financial products that are intended to result or may reasonably be expected to result, directly or indirectly, in:
 - (i) the making of offers to acquire or dispose of financial products; or
 - (ii) the acceptance of such offers.

What is a “facility”?

4 A facility is any form of infrastructure and an integrated infrastructure constitutes a single facility: see *Carragreen Currency Corporations Pty Ltd v Corporate Affairs Commission* (1986) 11 ACLR 298, 312-3. However, this does not mean that a person operates a financial market merely because they operate an electronic means of communication or are an Internet service provider: see Revised Explanatory Memorandum, paragraph 7.14.

What does “through” mean?

5 In view of the breadth of the meaning of facility, it is important that the function of the facility be considered; the law only regulates facilities “through which” offers or invitations are made or accepted. “Through” could be interpreted in a number of ways. In the context of s767A(1) it could mean “in consequence of”, “by reason of” or “by means of”. We have concluded that it should be construed narrowly and that a facility is only a financial market if the offers or invitations are made or accepted *by means of* the facility. That is, the offers or invitations must actually be made *on* the facility if the facility is to constitute a financial market.

6 We have reached this conclusion because the alternative, broader constructions of the phrase lead to a definition of a financial market that is inconsistent with the policy and object of financial market regulation in the FSR Act. For example, the word “through” could be construed so that a facility is within the definition of a financial market if it is a mere step in a process that results in the eventual making or acceptance of offers or invitations.

7 Such an interpretation would, however, mean that brokers and providers of general telecommunications services may be operating financial markets because they operate facilities that are a step in the process that results in the eventual making or acceptance of offers or invitations. There is no policy reason to regulate either of these persons as financial market operators and it is not intended to regulate general communications services as financial markets: see Revised Explanatory Memorandum, paragraph 7.14.

8 Our approach means that the various forms of infrastructure that are instrumental in the eventual making or acceptance of offers or invitations are not financial markets, if they are mere channels to the facility on which the offer or invitation is made or accepted.

What is an “offer” or “invitation”?

9 Paragraph (b) of s767A(1) indicates that the terms “offer” and “invitation” encompass formal contractual offers, requests to others to make a formal contractual offer and requests to enter a course of negotiations with a view to entering into a binding contract. The essential feature of both an offer and an invitation for the purposes of s767A is that the offer or invitation is intended by the offeror or inviter to result in a binding contract or may reasonably be expected to result in a binding contract. A binding contract for sale identifies both parties and price. Accordingly, we say that an offer or invitation will generally identify the person making the offer or invitation or their agent and the price.

10 Our approach to the meaning of offer is consistent with *AG for NSW v The Mutual Home Loans Fund of Australia Ltd* [1971] 2 NSWLR 162, 165 and *AG for NSW v Australian Fixed Trusts Ltd* [1974] 1 NSWLR 110, 117.

When and where is an offer or invitation “made” or “accepted”?

11 An offer or invitation is made when and where it is received by the offeree or invitee. Likewise, an offer or invitation is accepted when and where the offeror or inviter receives the acceptance. This approach is consistent with the common meaning of these terms: an offer, invitation or acceptance is made when and where it is communicated to and received by the recipient. This approach is also consistent with case law. Cases on the interpretation of the rules about jurisdiction over contractual disputes with a foreign element provide that a contractual acceptance, made by instantaneous means (essentially, any means of communication other than post or telegram) is completed or made when and where it is received. (See *Entores v Miles Far East Corporations* [1955] 2 QB 32; *Hampstead Meats Pty Ltd v Emerson and Yates Pty Ltd* [1967] SASR 109; *Express Airways v Port Augusta Air Services* [1980] Qd 543; *Mendelson-Zeller Co Inc v T & C Providores Pty Ltd* [1981] 1 NSWLR 366.) Additionally, the High Court has accepted that, generally, a statement “directed from one place to another where it is known or even anticipated that it will be received” is “made at the place to which it was directed”: *Voth v Manildra Flour Mills Pty Ltd* (1990) 171 CLR 538, 568.

12 A consequence of this approach, and our approach to “through” (outlined in explanation paragraphs 5 to 8 above), is that only a facility by means of which or on which offers, invitations or acceptances are received constitutes a financial market. A facility such as an order routing system that merely routes offers to another person for execution on another facility is not a financial market because there is no receipt of an offer on such a facility.

13 We note that a facility may constitute a financial market even if the binding contracts are not executed through the facility.

What is not a financial market?

14 Section 767A(2) sets out a number of exclusions from the definition of a financial market. We have no policy proposals about these exclusions; their scope is explained in the Revised Explanatory Memorandum: see paragraphs 7.15–7.16.

C Do you operate a financial market in Australia?

Policy proposal	Your feedback
<p>When does a financial market operate in Australia?</p> <p>C1 A financial market operates in Australia if it meets one or more of the following descriptions:</p> <ul style="list-style-type: none"> (a) the financial market is operated by a body corporate that is registered under Chapter 2A of the Corporations Act; (b) the financial market is located in Australia: see policy proposal paragraph C2; or (c) the financial market is available to and targeted at Australian investors: see policy proposal paragraphs C3 to C5. 	<p>C1Q1 Are there other circumstances in which a financial market operates in Australia? What are they?</p>
<p>When is a financial market located in Australia?</p> <p>C2 A financial market is <i>located</i> in Australia if:</p> <ul style="list-style-type: none"> (a) the market has a trading floor in Australia; (b) all or a significant part of the market infrastructure is located in Australia; or (c) the following conditions are satisfied: <ul style="list-style-type: none"> (i) the market provides participants with secure remote access to the market through proprietary market screens in their offices, so that participants can directly make or accept offers or invitations on the market by accessing the screen; and (ii) one or more of those screens is located in Australia. 	<p>C2Q1 Is this a complete list of the circumstances in which a market is located in Australia?</p> <p>C2Q2 Does a market operate in Australia if only one screen is located in Australia? In determining whether a market operates in Australia, should we also consider the number of screens in Australia and/or the volume of trading conducted via the screens located in Australia?</p>

Policy proposal	Your feedback
<p><i>When is a financial market available to Australian investors?</i></p> <p>C3 A financial market is available to Australian investors if a person in Australia has unintermediated access to the market. A person in Australia has <i>unintermediated access</i> to a financial market if they can acquire or dispose of a financial product through that market, on their own behalf or on behalf of another person, without intervention from an intermediary.</p> <p><i>When is a financial market targeted at Australian investors?</i></p> <p>C4 The following factors indicate that the financial market is targeted at Australian investors:</p> <ul style="list-style-type: none">(a) the operator conducts publicity campaigns designed to draw the attention of Australian investors to the market. Such campaigns include:<ul style="list-style-type: none">(i) advertising in Australian publications;(ii) direct mail publicity sent to Australian addresses; or(iii) e-mail publicity sent to Australian addresses;(b) the prices on the market are denominated in Australian dollars; or(c) the market is regularly used by Australian investors. <p>The above factors are not exhaustive.</p>	<p>C4Q1 Do all these factors indicate that a market is targeted at Australian investors?</p> <p>C4Q2 Are there any other relevant factors? If so, what are they?</p>

Policy proposal	Your feedback
<p>C5 The following factors indicate that the financial market is <i>not</i> targeted at Australian investors:</p> <ul style="list-style-type: none">(a) when a person in Australia gains access to the market, the person is presented with information that clearly and prominently states that the market is targeted at residents of some other jurisdiction;(b) when a person in Australia gains access to the market, the person is presented with information that clearly and prominently lists the jurisdictions (other than Australia) in which the market is authorised to operate and this information is true; or(c) the operator takes precautions designed to prevent use of the market by Australian investors. Such precautions include the screening of invitations, offers and acceptances from Australian addresses. Precautions that merely require a user to identify whether he or she is an Australian investor are insufficient. <p>The above factors are not exhaustive.</p>	<p>C5Q1 Do all these factors indicate that the market is not targeted at Australian investors?</p> <p>C5Q2 Are there any other relevant factors? If so, what are they?</p>

Explanation

1 A person only requires an Australian market licence if they operate a financial market in Australia. Section C of this policy proposal outlines when a financial market operates in Australia. You should also consider the Schedule: What types of activities will require an Australian market licence?

2 The proposals in policy proposal sub-paragraphs C1(a) to (c) are not mutually exclusive; a market operates in Australia if it meets one or more of the listed descriptions.

3 Section 791D(1) provides that a financial market is taken to be operated in Australia if it is operated by a body corporate that is registered under Chapter 2A of the Corporations Act.

4 Section 791D(2) has the effect that the other circumstances in which a market is operated in this jurisdiction should be determined by reference to general principles.

5 We believe that policy proposal sub-paragraphs C1(b) and (c) list the other circumstances in which a market is operated in this jurisdiction. In arriving at this conclusion, we have taken into account:

- (a) the globalisation of financial markets and the use of communications networks, such as the Internet, that do not recognise international boundaries. We accept that it is neither feasible nor appropriate for Australian law to attempt to regulate all markets that may be directly accessed by Australian investors;
- (b) Parliament's intention to protect Australia's reputation as a global financial centre: see Revised Explanatory Memorandum, paragraph 7.19. This reputation would be undermined if unscrupulous and unregulated operators of financial markets were located in Australia; and
- (c) the need to protect Australian investors.

6 We have also taken into account the approach of international organisations and regulators in other jurisdictions to the issue of when regulatory authority should be asserted over activities on the Internet. Our approach is consistent with:

- (a) the IOSCO recommendations on the exercise of regulatory authority over cross-border securities activities on the Internet: see Security Activity on the Internet: A Report of the Technical Committee of IOSCO, 1998;

- (b) ASIC Policy Statement 141 *Offers of Securities on the Internet* [PS 141];
- (c) the United States Securities and Exchange Commission's approach to the use of Internet websites to disseminate offering and solicitation materials for offshore sales of securities and investments services: see Interpretative Release: Re: Use of Internet Websites to Offer Securities, Solicit Securities Transactions, or Advertise Investment Services Offshore, Release 34-39779, 1998;
- (d) the United Kingdom Financial Services Authority's approach to regulation of activity on the Internet: see Discussion Paper: The FSA's Approach to Regulation of E-Commerce, June 2001, pp 22-23; and
- (e) the Hong Kong Securities and Futures Commission's approach to regulation of securities or commodity trading or advisory activities conducted over the Internet via off-shore sites: see Guidance Note on Internet Regulation, March 1999.

7 Determining whether the market targets Australian investors will require an assessment of all the facts and circumstances pertaining to the market. The factors referred to in policy proposal paragraphs C4 and C5 are indicative only. In most circumstances, an operator that wants to establish that the market does not target Australian investors will need to point to a number of relevant factors; a jurisdictional disclaimer by itself is unlikely to be sufficient.

8 We also note that a market may be operated simultaneously in Australia and other jurisdictions. This is implicit in s795B(2) and the scheme for the licensing of overseas markets in Part 7.2.

D What is our approach to exemptions?

Policy proposal	Your feedback
<p>When will we advise the Minister to exempt a financial market?</p> <p>D1 We will only advise the Minister that an exemption should be granted in rare and exceptional circumstances.</p> <p>D2 We will normally advise the Minister to exempt a particular market or type of market only if that market or type of market falls within the definition of financial market but:</p> <p>(a) does not require any regulation in order to achieve the regulatory outcomes in Table A; or</p> <p>(b) does not require regulation as a financial market in order to achieve the regulatory outcomes in Table A because it is subject to other forms of regulation, such as by the financial services licensing regime.</p> <p>D3 We will not advise the Minister that an overseas market should be exempted solely because the market is subject to regulation in the foreign country in which its principal place of business is located.</p> <p>Note: The operator of such a market should seek a licence under s795B(2) or (1).</p> <p>D4 We will not advise the Minister that a market should be exempted solely because there is doubt about whether the products traded on the market are, or should be, within the definition of a financial product.</p> <p>Note: In these circumstances, the operator should seek a declaration under s765A(2).</p>	<p>D2Q1 Are there other circumstances in which we should advise the Minister to exempt a financial market?</p> <p>D2Q2 Do low volume markets fall within policy proposal sub-paragraph D2(a)? If so, how do you think these low volume markets should be defined?</p> <p>D3Q1 Are there circumstances in which we should advise the Minister to grant an exemption to an overseas market?</p>

Policy proposal	Your feedback
<p>What is our approach to conditions on the exemption?</p> <p>D5 We will not advise the Minister to exempt a particular financial market or type of financial market where we consider that substantive conditions would need to be imposed on the exemption.</p> <p>D6 However, we consider that the following conditions are not substantive and we may advise the Minister to impose these or similar conditions on an exemption, that:</p> <ul style="list-style-type: none">(a) the operator hold the appropriate Australian financial services licence;(b) the features of the market remain as they were when the exemption was granted;(c) the operator report to us once a year so that we can satisfy ourselves that the operator is complying with the conditions on the exemption; or(d) the operator alert users of the market to the fact that the market is exempted from the operation of Part 7.2. <p>What should you do if you want an exemption?</p> <p>D7 If you want the Minister to exempt a particular financial market or type of financial market, you should apply to us by letter. Your application should fully describe:</p> <ul style="list-style-type: none">(a) the operation of the particular financial market or type of financial market; and(b) the reasons why it should be exempted from the operation of Part 7.2 in light of the principles in policy proposal paragraph D2.	<p>D5Q1 Are there circumstances in which substantive conditions should be imposed on an exemption?</p>

Policy proposal

Your feedback

D8 We will aim to provide the Minister with advice about your application for exemption within two months of receiving an application that contains all documents and information needed by us to assess your application. The 2-month period does not include time during which we are waiting for you to respond to a request for further information or a consultation period if we need to consult with the public about the application.

Note: The 2-month period does not include the time the Minister takes to consider your application or, if necessary, comply with the procedure in s791C.

Explanation

When will we advise that the Minister exempt a financial market?

1 Parliament does not intend that the exemption power in s791C be used to provide an alternative regulatory regime for financial markets. More than one regime is unnecessary because Part 7.2 of the FSR Act creates a flexible regulatory regime, capable of being tailored to meet the regulatory requirements of different types of markets. Accordingly, Parliament envisages that the exemption power will only be used in very limited circumstances, such as when there is no policy reason to regulate an activity as a financial market: see, generally, Revised Explanatory Memorandum, paragraphs 7.26 and 7.27.

2 In light of this narrow approach to granting exemptions, we propose to advise the Minister to grant an exemption to a particular financial market or type of financial market only if there is no public benefit in regulating it as a market. We envisage this will occur only rarely.

3 In some circumstances, a facility that falls within the definition of a financial market in s767A does not require any form of regulation in order to achieve the regulatory outcomes referred to in Table A. In other circumstances, other forms of regulation, such as financial services regulation, may be adequate to achieve these regulatory outcomes. In both these sets of circumstances, there is no public benefit in regulating the facility as a market.

4 Low volume markets may fall within the criteria identified in policy proposal sub-paragraph D2(a). Electronic trading systems operated by participants of a licensed financial market may fall within the criteria in policy proposal sub-paragraph D2(b), provided they are adequately regulated by the operator of the licensed financial market: see the Schedule: What types of activities will require an Australian market licence?

5 We will advise the Minister that an overseas market should not be exempted solely because the market is subject to regulation in the foreign county in which its principal place of business is located. If financial markets were exempted on the basis that they are subject to adequate foreign regulation, the licensing regime for overseas markets in Part 7.2 would be undermined.

What is our approach to conditions on the exemption?

6 As previously stated, the exemption power is not to be used to create an alternative regulatory regime. Therefore, we will not advise that exemptions be granted where the exemptions would be subject to substantive conditions that constitute a substitute regulatory regime.

E Obligations of market licensees

Policy proposal	Your feedback
<p>Demonstrated compliance with all obligations</p> <p>E1 One of ASIC’s key functions is to assess and report to the Minister on a market licensee’s compliance with its general obligations under s792A. Market licensees have specific obligations under s792B, 792C, 792D, 792E and 792F designed to assist ASIC in performing this assessment function.</p> <p style="padding-left: 40px;">Note: ASIC may at any time assess a market licensee’s compliance with any or all of its obligations. However, ASIC must do an assessment of the market licensee’s compliance with its supervisory obligations at least once a year: see policy proposal paragraphs E10 and E11 and explanation paragraphs E2 and E12.</p> <p>E2 A market licensee must be able to positively demonstrate to us that it is complying with all its obligations under Chapter 7 from the time a market licence is granted and continuously thereafter:</p> <ul style="list-style-type: none"> (a) by its operating rules, documented procedures, plans and other written records; and (b) by its operational processes, practices, systems and structures. <p>E3 What market licensees need to do to comply with their obligations will depend on the nature, scale and complexity of the market the licensee operates. It will generally depend on three main factors:</p> <ul style="list-style-type: none"> (a) what form the market takes; (b) what products are traded on the market; and 	<p>E2Q1 What forms of documentation should we expect a market licensee to provide to us in demonstrating its compliance?</p>

Policy proposal

- (c) who the participants and market users are, especially whether retail users have direct or indirect access to the market.

Note: In this paper, we do not intend to give guidance on all compliance matters that might arise from the market licensee obligations. We will review our guidance from time to time based on our experience to ensure that it deals with what is most important to ASIC.

Planning for compliance

E4 It is the responsibility of each market licensee to determine how it will ensure that it is continuously complying with all its obligations. However, we think that a market licensee will best be able to:

- (a) ensure its compliance with all its obligations; and
- (b) analyse, for the annual report, the extent of its compliance (see reg 7.2.06(c) and policy proposal paragraph E21),

if it actively plans how it proposes to ensure that compliance, and how it proposes to monitor and assess its own compliance during the year.

Assessing compliance by market licensees

E5 When we assess how well a market licensee is complying with its Chapter 7 obligations, we will take into account, but not be limited to:

- (a) the market licensee's annual report for the previous year, including the market licensee's analysis of its own compliance: see policy proposal paragraph E21;
- (b) any planning the market licensee has done towards ensuring its compliance

Your feedback

E4Q1 Are there any practical problems raised by this proposal? If so, what are they?

E5Q1 Are there other matters we should consider when assessing if a market licensee is complying with all its obligations? If so, what are they?

Policy proposal

and any self-monitoring of compliance conducted by the market licensee: see policy proposal paragraphs E4 and E10;

- (c) the degree of organisational independence of the market licensee's activities for monitoring its own compliance. This includes:
 - (i) the market licensee's governance and reporting structures for its commercial, supervisory and self-monitoring activities; and
 - (ii) the extent to which persons responsible for monitoring the market licensee's compliance with its obligations are protected from potential conflicts of interest under the terms of their engagement; and
- (d) the results of our own monitoring program.

Note: Under s794C, ASIC may take into account any information and reports that it thinks appropriate, including information and reports from an overseas regulatory authority.

Fair, orderly and transparent

E6 A market licensee's obligation under s792A(a) to ensure that the market is fair, orderly and transparent applies both as:

- (a) a broad description of all the market licensee's obligations; and
- (b) a separate obligation that the market licensee must comply with.

Your feedback

Policy proposal

E7 We interpret the introductory words in s792A(a), “to the extent that it is reasonably practicable to do so”, as qualifying the obligation to “do all things necessary”. In other words, a market licensee must do everything reasonably practicable to ensure that the market is fair, orderly and transparent.

E8 When we assess whether a market licensee is doing everything reasonably practicable to ensure that the market is fair, orderly and transparent, we will consider the market licensee’s individual circumstances and the operation of the market as a whole. We do not consider that cost alone will mean it is not reasonably practicable to do a particular thing, unless the cost involved is manifestly excessive or unreasonable when compared to the market integrity, investor protection or other benefits to market users that would result from doing the thing.

E9 “Fair”, “orderly” and “transparent” have different meanings and refer to different market characteristics. When we assess whether a market licensee is complying with the obligation to ensure that the market is fair, orderly and transparent, we will consider those words individually and collectively, and whether the way the market operates is consistent with the market integrity and investor protection outcomes that the law requires.

Note: The market integrity and investor protection outcomes that the law requires are the regulatory outcomes identified in Table A.

Your feedback

E8Q1 In what circumstances might it not be reasonably practicable for a market licensee to do all things necessary to ensure that the market is fair, orderly and transparent? Please provide examples.

E9Q1 Do we need to provide more detailed guidance on the meaning of fair, orderly and transparent? If so, what form of guidance should we provide?

Policy proposal

Your feedback

Supervisory obligations

Planning for and demonstrating compliance

E10 While it is the responsibility of each market licensee to determine how it will ensure that it is complying with all its obligations (see policy proposal paragraph E4), the obligation under s792A(c) to have adequate arrangements for supervising the market is so integral to the operation of the market that we think a market licensee should, at the beginning of each year:

- (a) plan in detail how it proposes during the forthcoming year to ensure that its supervisory arrangements will be adequate, including how the supervisory obligations will be performed and how the market licensee will monitor and assess the adequacy over the year of its supervisory arrangements; and
- (b) make the plan available to ASIC if asked to so.

Note: An applicant for a market licence will need to provide with its application evidence of how it will comply in the future with all its obligations: see s795B(1)(b). We will expect this evidence to include compliance planning of the type referred to above: see policy proposal paragraph F2.

Assessing compliance

E11 ASIC must assess and report to the Minister at least annually on a market licensee's compliance with its obligation under s792A(c) to have adequate arrangements for supervising the market: see s794C(2) and (3). We will usually do an assessment after we receive the market licensee's annual report required under s792F.

E10Q1 Are there any circumstances when it would not be reasonable for us to expect a market licensee to:

- (a) have a plan of this nature; or
- (b) make a copy of the plan available to ASIC?

If so, please briefly explain your response.

Policy proposal

Note: ASIC may also do an assessment at any other time.

E12 When we assess a market licensee's compliance with the obligation to have adequate arrangements for supervising the market, we will take into account the factors mentioned in policy proposal paragraph E5, with particular emphasis on:

- (a) how the market licensee monitors trading and other market activity to detect potential or actual non-compliance with the law or the market's operating rules by any of the participants, their clients or entities whose products are traded on the market;
- (b) how and to what extent the market licensee monitors the relationship between participants and their clients, and the financial capacity of participants;

Note: See policy proposal paragraph E14.

- (c) how the market licensee deals with complaints about the market or participants;
- (d) how the market licensee deals with actual or suspected breaches of the law or the market's operating rules, including remedial, disciplinary and other deterrent measures;
- (e) the resources available and utilised for conducting supervisory activities;
- (f) whether there are adequate arrangements for sharing supervisory responsibilities and information with:
 - (i) ASIC; and
 - (ii) operators of other markets and clearing and settlement facilities

Your feedback

E12Q1 Are there additional matters we should specifically consider, or matters listed that we should not consider, when assessing the adequacy of a market licensee's supervisory arrangements? If so, what are they?

Policy proposal	Your feedback
<p>with the same participants as the market licensee; and</p> <p>(g) how the market licensee identifies and deals with potential or actual conflicts between its commercial interests and its obligation to provide a fair, orderly and transparent market.</p> <p>Handling conflicts</p> <p>E13 We will not assess as adequate a market licensee’s arrangements for handling conflicts unless:</p> <p>(a) under the arrangements, actual or potential conflicts are reliably identified and appropriately responded to;</p> <p>(b) the market licensee’s governance and reporting structures clearly separate the market licensee’s commercial activities from its supervisory activities; and</p> <p>(c) the arrangements comply with any regulations made under s798E.</p>	<p>E13Q1 Do we need to provide more guidance on how we will assess the adequacy of arrangements for handling conflicts? If so, what form of guidance should we provide?</p>
<p>What participant conduct must be supervised?</p> <p>E14 We interpret the obligation in s792A(c)(ii) to monitor conduct of participants “on or in relation to the market” as requiring market licensees to supervise conduct by a participant that:</p> <p>(a) leads to or is part of a transaction on the licensed market; or</p> <p>(b) is connected with the settlement of transactions effected on the market; or</p> <p>(c) relates to dealings between the participant and its clients or potential clients connected with making or settling transactions on the market or otherwise effected in accordance with</p>	<p>E14Q1 Does this proposal cover all the participant conduct that a market licensee should supervise? Does it cover conduct that a market licensee should not be required to supervise? Please briefly explain your response.</p> <p>E14Q2 Will there be practical problems in separating a participant’s non-market related business activities from its market-related activities? How might any</p>

Policy proposal	Your feedback
<p>the market’s operating rules; or</p> <p>(d) relates to a participant’s ability to comply with the law or the market’s operating rules and to meet all its obligations (including financial obligations) for business connected with the licensee’s market.</p> <p>What organisational resources are sufficient?</p> <p><i>Financial resources</i></p> <p>E15 A market licensee must at all times have sufficient liquid financial resources of its own, or unconditional and irrevocable access on short notice to liquid financial resources. “Sufficient” means enough financial resources, on a worst case analysis of prospective revenue and expenses, to fund the financial requirements of all of the market licensee’s operations during at least the next 12 months.</p> <p><i>Technological resources</i></p> <p>E16 If a market licensee plans a significant change in its technological resources, we will normally require an independent expert to verify, at the licensee’s expense, the ongoing adequacy of its technological resources.</p>	<p>such difficulties be overcome?</p> <p>E14Q3 What arrangements might be needed to ensure supervisory responsibilities work effectively where participants are active in more than one licensed market?</p> <p>E15Q1 Is this test sufficiently stringent to adequately protect all market users? Is 12 months the appropriate time in all cases?</p> <p>E16Q1 Do we need to provide more guidance on what are sufficient financial, technological and human resources, or on any other categories of resources? If so, what form of guidance should we provide?</p>

Policy proposal

Your feedback

What are adequate Division 3 compensation arrangements?

E17 We interpret the legislation as requiring market licensees to be directly responsible for establishing, controlling and maintaining any compensation arrangements required under Division 3 of Part 7.5.

E18 We interpret s792A(e) as requiring market licensees to be directly responsible for the ongoing adequacy of their Division 3 compensation arrangements.

E19 We will not adopt a final policy on compensation arrangements under Division 3 of Part 7.5 before we know the Government's response to CASAC's review of compensation arrangements in the financial sector. In the meantime, we will assess each case individually and will be flexible in how we assess whether particular arrangements are adequate for the purposes of s885B.

Note: For information about the CASAC review, see explanation paragraph E27.

Information about Part 7.5 compensation arrangements

E20 We think that the information a market licensee must make publicly available under s792I is up-to-date information that assists retail investors to understand their rights and remedies under the compensation arrangements. This includes information about:

- (a) the types of claims which can be made, by whom, how, and any relevant time limits for making claims;
- (b) what type of compensation may be provided and any monetary limits on

E19Q1 Do we need to provide more guidance on our interim policy at this stage, for:

- (a) applicants for a new market licence; or
- (b) existing market operators?

E20Q1 Are there any practical problems raised by this proposal? If so, what are they?

Policy proposal	Your feedback
<p>that compensation;</p> <ul style="list-style-type: none"> (c) who administers the compensation arrangements, what the source of funds is, and the total size of the arrangements; (d) how long it takes to process claims, who makes the decisions about claims, and what review (if any) of decisions about claims is available; and (e) what investigation of the claim is undertaken, to whom information about the claim may be provided, and any other relevant confidentiality or privacy-related information. 	
<p>Annual report</p> <p>E21 Regulation 7.2.06 sets out the information that a market licensee’s annual report must contain or be accompanied by. We expect the analysis referred to in regulation 7.2.06(c) to:</p> <ul style="list-style-type: none"> (a) identify and explain any divergences during the year between the market licensee’s planned and actual activities and resources for performing its obligations and for monitoring its own performance of those obligations; (b) state the objective outcomes and standards against which the market licensee has measured its compliance with each of its obligations, and explain why those outcomes and standards evidence compliance with the particular obligation; and (c) state and explain the market licensee’s conclusions about: <ul style="list-style-type: none"> (i) whether it has achieved those outcomes and standards and the extent to which it has fully 	<p>E21Q1 Do we need to provide any other guidance about the annual report? If so, what type of guidance do you think is needed?</p> <p>E21Q2 Do we need to provide guidance on when we will advise the Minister to require an annual report to be audited (see s792F(4)) or to require a special report under s794B?</p>

Policy proposal

- complied with each obligation;
- (ii) the adequacy and effectiveness of its operating rules and procedures and of its supervisory arrangements in achieving a fair, orderly and transparent market;
 - (iii) the strengths and any weaknesses in its activities and resources for performing each of its obligations;
 - (iv) the strengths and any weaknesses in its activities and resources for monitoring its own performance of each of its obligations;
 - (v) if less than full compliance is identified under sub-paragraph (i) above, how the market licensee proposes to amend its processes to ensure it does achieve full compliance with each obligation; and
 - (vi) if any inadequacy has been identified under sub-paragraph (ii), or any weaknesses have been identified under sub-paragraphs (iii)-(iv) above, how the market licensee proposes to address those matters.

Your feedback

Explanation

1 The main obligations a market licensee must comply with on a continuing basis are set out in s792A. Additional specific obligations are set out in s792B–792I. We do not discuss in this paper every market licensee obligation under Chapter 7 of the FSR Act.

Demonstrated compliance with all obligations

2 ASIC has a power (see s794C(1)) and an obligation (see s794C(2)) to assess how well a market licensee is complying with its obligations under Chapter 7. Paragraph 7.114 of the Revised Explanatory Memorandum refers to ASIC’s ability to do an assessment at any time of a market licensee’s compliance with all, or any one or more of its obligations.

3 Market licensees should be aware that in some cases, breach of an ongoing obligation is an offence under s1311(1). This reinforces the need to be able to demonstrate compliance.

Planning for compliance

4 We think it is unlikely that a market licensee will be able to ensure compliance with its s792A obligations, notify us of potential or actual breaches, satisfy us from time to time that it is complying with all its obligations, and make the analysis of its compliance we expect in its annual report, if the market licensee does not plan how it will perform, monitor, rectify where necessary, report on (both internally and externally) and evaluate its own compliance with all its obligations.

5 We expect market licensees to plan how they will comply with, and how they will monitor their compliance with, all their obligations as market licensees because this:

- (a) is best practice and is an integral part of overall strategic planning for a regulated business operation;
- (b) involves decision-makers within the market licensee in the responsibility for maintenance of the market licence;
- (c) minimises the likelihood of gaps in monitoring compliance;
- (d) provides an opportunity to focus on outcomes of the monitoring process;

- (e) promotes a more objective evaluation of the market licensee's performance and the extent of compliance by the market licensee and the persons and activities the market licensee is responsible for supervising;
- (f) provides a tool for internal and external accountability;
- (g) provides an audit trail;
- (h) facilitates reporting to us of actual or potential breaches of the licensee's obligations;
- (i) facilitates preparation of the licensee's annual report to us; and
- (j) will assist the market licensee in positively demonstrating to us its compliance.

6 We expect that a market licensee's planning would address:

- (a) the mechanisms for performing each obligation;
- (b) the outcomes and standards against which compliance with each obligation will be measured and why these have been selected;
- (c) the procedures, resources and timetables for monitoring the market licensee's performance of each obligation; and
- (d) the procedures and structures for internal and external reporting of the outcomes of the monitoring process.

7 We also expect that the processes for monitoring and measuring the market licensee's own compliance would:

- (a) be comprehensive enough and frequent enough to reliably identify situations of actual or potential breaches of obligations by:
 - (i) the market licensee; or
 - (ii) others that the market licensee is responsible for supervising, such as participants and listed entities;
- (b) deal adequately with any breaches detected, and ensure appropriate remedial, disciplinary or enforcement action is taken;
- (c) include mechanisms that require the market licensee to reassess its compliance with its obligations if there are changes in:
 - (i) market operations;
 - (ii) market users;

- (iii) operating rules; or
- (iv) the market licensee's resources; and
- (d) enable the market licensee to fairly and reasonably conclude whether and how well it has complied with each of its obligations.

8 Market licensees must assist in any assessment by ASIC of the market licensee's compliance with any or all of its obligations: see s792D. We expect this assistance to include providing us with a record of its planned and actual compliance monitoring activities, and the results of those monitoring activities.

Fair, orderly and transparent

9 We consider that the obligation in s792A(a) to ensure that the market is fair, orderly and transparent applies both as a broad description of all the market licensee's obligations and as a separate obligation of the market licensee. The obligation underlies all the other market licensee obligations. If a market licensee does not meet one of its other market licensee obligations, it would suggest that the market licensee is not meeting this obligation.

10 Section 792A(a) qualifies a market licensee's obligation to do everything necessary to ensure that the market is fair, orderly and transparent by reference to "the extent that it is reasonably practicable to do so". A market licensee that does not wish to do something that is necessary must establish that it is not reasonably practicable for the market licensee to do that thing.

When we consider whether it is "not reasonably practicable" to do a particular thing necessary to ensure that the market is fair, orderly and transparent, we will aim to balance the burden on the market licensee of doing that thing against other relevant factors, including any potential detriment to affected market users, market integrity, investor protection or the reputation of the market that may occur, if the particular thing is not done.

11 In addition to our general ability to assess at any time a market licensee's compliance with the obligation in s792A(a), we will consider the effect on the fairness, orderliness and transparency of the market of any proposed changes to:

- (a) the way a market operates;
- (b) clearing and settlement arrangements for transactions effected on the market;

- (c) a market licensee's operating rules or associated procedures; or
- (d) the arrangements or resources for supervising the market.

Note: The market licensee's obligation under s792A(a) is one the Minister must have regard to under s793E(4) when considering changes to operating rules.

Supervisory obligations

Planning for and demonstrating compliance

12 The FSR Act imposes on ASIC an obligation (rather than a discretion) to do an assessment at least annually of the market licensee's compliance with its obligation to have adequate supervisory arrangements. This underlines the regulatory importance of compliance by market licensees with their supervisory obligations. We think it also means that market licensees should provide ASIC each year with their planning about their supervisory obligations.

13 Effective performance of a market licensee's supervisory obligations is integral to the fairness, orderliness and transparency of the market. Measures that ensure compliance with the supervisory obligations under s792A(c) will be relevant to compliance with the obligation under s792A(a) to ensure that the market is fair, orderly and transparent. There will also be a degree of overlap between the measures that ensure compliance with the obligation under s792A(c) to have adequate arrangements for supervising the market, and measures that ensure compliance with the obligation under s792A(d) to have sufficient resources.

Handling conflicts

14 Regulations may be made under s798E which deal with conflict situations and the way they are to be resolved. In the absence of regulations, in order to comply with s792A(c)(i), a market licensee will need to anticipate situations of potential or actual conflict and have arrangements in place for recognising and appropriately responding to such situations.

15 A conflict may arise in any situation where a market licensee makes supervisory or regulatory decisions. This includes decisions about:

- (a) access to the market as either a participant or a listed entity;

- (b) access to clearing and settlement facilities operated by the market licensee or a related entity;
- (c) how and what monitoring takes place;
- (d) investigative or disciplinary action; or
- (e) the exercise of discretions such as the granting of waivers from operating rules or charging of variable fees.

Conflicts may involve, for example, the market licensee's competitors (actual or potential), joint venturers, associates, or entities in which the market licensee has a significant shareholding. Conflicts may also involve the market licensee's securities or other financial products derived from the market licensee's securities.

16 We do not think that supervisory arrangements will be adequate unless there is a clear separation of the supervisory activities and commercial activities of the market licensee. For example:

- (a) if one person's job responsibilities involve both supervisory and commercial activities, the person should report to different people for each type of activity; and
- (b) a person who is responsible for monitoring the market licensee's compliance with its supervisory obligations (including monitoring the adequacy of the arrangements for handling conflicts) should report to a person who is not responsible for making commercial decisions, or to a committee of the market licensee's board with a majority of independent, non-executive members.

What participant conduct must be supervised?

17 Under s792A(c)(ii), a market licensee's supervisory arrangements must include arrangements for monitoring the conduct of participants on or in relation to the market. A market licensee is not required to monitor all the diversified business activities of participants in its market. The arrangements for monitoring participant conduct will normally include relevant provisions of the market's operating rules.

18 Regulation 7.2.07(b) sets out what must be included in a market licensee's operating rules in relation to conduct of participants. Paragraphs 7.2.07(b)(i) and (iii) refer to conduct "promoting honesty and fair practice" and conduct "inconsistent with just and equitable principles in the transaction of business". Regulation 7.2.07(g) refers to assessing and investigating market-related disputes between participants and clients.

19 We think these requirements for operating rules make it clear that the obligation to monitor participant conduct includes monitoring the relationship between participants and their clients (or potential clients) in connection with doing business on the licensed market or in accordance with the market’s operating rules. Although participants will also be subject to supervision by ASIC, and may also be subject to supervision by another market licensee, a market licensee cannot ignore inappropriate or unlawful conduct by its participants, which is connected with a client’s potential or actual trading on the licensee’s market, and from which the market licensee may directly or indirectly benefit or suffer.

20 We also think that a participant’s conduct does not fall outside the scope of a market licensee’s supervisory obligations merely because of uncertainty about the market to which the particular conduct relates, or was intended to relate. We think that in such circumstances, market licensees need to have arrangements with other relevant market licensees for allocating their supervisory obligations and sharing information.

What organisational resources are sufficient?

21 A market licensee’s resources must at all times be sufficient both to operate the market properly and to meet the supervisory obligations: see s792A(d). We will assess ongoing sufficiency on a case-by-case basis.

We will interpret “properly” in s792A(d) to mean “in the way mentioned in s792A(a)”, which is the wording used in s792A(c).

22 A market licensee’s measures for ensuring its compliance with its obligations should include processes for reassessing the sufficiency of its resources whenever a significant change in the resources or in the operation of the market occurs or is likely to occur. For example, the sufficiency of the market licensee’s resources to enforce compliance with its operating rules may be threatened if several members of staff in one section depart.

Financial resources

23 A market licensee must have sufficient financial resources in order to provide an ongoing, fair, orderly and transparent market. Sufficient financial resources are essential for the continuity of the market and the protection of market users. We think that if a market licensee meets the requirements in policy proposal paragraph E15, there should be sufficient resources to fund the ongoing operation of

the market or to fund its orderly winding down if that becomes necessary. However, it is up to the market licensee to ensure that it has sufficient financial resources to comply with all its obligations.

24 In selecting 12 months as the minimum period for which a market licensee must have committed liquid financial resources to fund all its operations, we have been guided by the reference to 12 months in reg 7.2.12(h) and by our own experience in dealing with markets.

25 A market licensee's financial resources must be sufficient to fund all the operations of the licensee and not just the operation of a particular market, because the stability and continuity of a particular market cannot be separated from the overall financial health and continuity of the licensee.

26 We think that the assessment of the amount required to fund the market licensee's operations must be on a "worst case" analysis of prospective revenue and expenses over the next 12 months. For some market licensees, this will mean that it will not be appropriate to include any prospective revenue in the assessment (for example, if there is uncertainty about deriving revenue). For longer-established market licensees, the market's history of operation can be taken into account in determining a "worst case" analysis of prospective revenue and expenses.

What are adequate Division 3 compensation arrangements?

27 In April 2001, the Minister asked the Companies and Securities Advisory Committee (CASAC) to consider a wide range of issues relating to compensation arrangements in the financial services sector. CASAC's report is due in January 2002, before FSR commencement. We will not adopt a final policy on assessing the adequacy of Division 3 compensation arrangements before we know the Government's response to CASAC's review. Until a final policy can be formed, when we assess and advise the Minister about the adequacy of particular Division 3 compensation arrangements, we will be concerned to ensure that retail clients have adequate redress but will attempt not to involve the market operator in major "structural" change or investment.

28 There will be a maximum transition period of 2 years for certain market operators to which Division 3 of Part 7.5 would otherwise apply. For those markets to which a transition period applies, current compensation arrangements are preserved (subject to the regulations). From FSR commencement, licensees of markets without the benefit of the transitional provisions will have to meet

the requirements for compensation arrangements as set out in Part 7.5, unless regulations are made under s893A. That section enables regulations to be made in relation to the operation of the whole of Part 7.5, including by exempting persons or financial markets from all or any part of Part 7.5.

29 Under s792A(e) and 881A(1), a market licensee must ensure that there are approved Division 3 compensation arrangements in relation to its market, and has a number of ongoing obligations in relation to those arrangements. These include:

- (a) complying with licence conditions about the minimum amount of cover and source of funds for compensation arrangements: see s792A(b), 796A(5) and 882A(4);
- (b) notifying us under s792B(1) if it becomes aware of anything as a result of which the Division 3 arrangements may no longer be adequate, or if the licence conditions referred to in (a) may be breached;
- (c) complying with written directions under s882D to do things to make the arrangements adequate;
- (d) changing the arrangements only in accordance with s884A–884C;
- (e) reporting to the board of the market licensee under s885I(1) on compliance with, and the adequacy of, the compensation arrangements; and
- (f) providing to the Minister (if required) a risk assessment report under s892K, for use in assessing compliance with, and the adequacy of, the compensation arrangements: see s885B(2) and 885J.

30 If the Minister considers at any time that compensation arrangements under Division 3 of Part 7.5 are not adequate, an existing approval of the arrangements may be revoked: see s882C. Inadequacy of the compensation arrangements therefore jeopardises the licence of a market licensee required to have Division 3 compensation arrangements.

31 We think that the combination of these compensation obligations, and the potential impact on a market licensee’s licence in the event of non-compliance, mean that the obligation on the market licensee under s792A(e) is to have compensation arrangements that are under its control. A market licensee cannot satisfy its Division 3 compensation obligations by pointing to arrangements under the control of someone else, such as individual insurance arrangements put in place by a participant in the

licensee's market, or an external dispute resolution scheme to which some or all of the participants in the licensee's market belong.

32 However, it may be reasonable with appropriate safeguards, for a market licensee to outsource or delegate aspects of the administration of its compensation arrangements. That possibility is contemplated in s885I(2).

33 We think the FSR Act also requires the market licensee to have ultimate responsibility for the determination of claims made under its Division 3 arrangements and for payment of compensation, as this is an aspect of the market licensee's control of the arrangements. This follows from provisions such as s883C (other sources of funds), s892D (powers of relevant authorities) and the levy provisions in s883D.

34 We think that a market licensee's obligation under s792A(e) in relation to Division 3 compensation arrangements extends beyond merely ensuring that the arrangements as originally approved continue to exist, and imposes a positive obligation on the market licensee to ensure their ongoing adequacy.

Source of funds

35 Note 1 to s885H identifies insurance arrangements as an example of a source of compensation funds. We think that any such insurance arrangements must be arrangements of the market licensee in connection with its liability to provide compensation in respect of Division 3 losses and any other losses covered by the compensation arrangements.

Changing the compensation arrangements

36 Except for minor administrative changes to matters not required by s885B to be contained in compensation rules, proposed changes to the compensation arrangements will involve an assessment of the adequacy of the arrangements after the change: see s884B(7) and 884C(3). Adequacy will be assessed in accordance with our interim policy referred to above.

Ensuring compliance with requirements for Division 3 arrangements

37 Compensation arrangements are defined in s880B as compensation rules, a source of funds and associated administrative and monitoring arrangements. We expect the procedures for monitoring and reporting on Division 3 compensation arrangements to be part of the market licensee's overall planning for how it will

comply with its Chapter 7 obligations. This would also enable the reporting required under s885I, on the adequacy of the compensation arrangements and any breaches of those arrangements, to be made against criteria and in a manner previously agreed by the board of the market licensee.

Information about Part 7.5 compensation arrangements

38 The obligation in s792I to take reasonable steps to ensure that information about the compensation arrangements is available to the public free of charge applies to all market licensees with compensation arrangements under Divisions 3 or 4 of Part 7.5. The publicly available information in some cases may need to be updated annually. This should be taken into consideration when choosing how information about compensation arrangements is to be made available to the public. The Revised Explanatory Memorandum refers to the market's Internet site as a possible avenue for making the information publicly available: see paragraph 7.65. We think the information must also be available to members of the public without Internet access.

Annual report

39 Section 792F requires a market licensee to prepare an annual report on the extent to which it complied with its obligations under Chapter 7. Regulation 7.2.06 sets out the information that must be contained in or accompany the annual report.

40 We think the analysis referred to in reg 7.2.06(c) should essentially be a form of self-assessment against previous planning by the market licensee about the activities, resources and standards intended to be used to ensure, and assess, its compliance with its obligations. In relation to the market licensee's conclusions about the extent of its compliance, we expect an appraisal of the market licensee's performance, including discussion of areas where the performance or the monitoring may have failed or could be enhanced, and whether any enhancements to the performance or monitoring arrangements are proposed.

F How do you obtain an Australian market licence?

Policy proposal	Your feedback
<p>What must you include with your application?</p> <p>F1 An application must include the information and documents referred to in reg 7.2.11 and 7.2.12. Where the regulations require “a description” or “details” of certain matters, we expect the applicant to provide sufficient description or details to provide ASIC and the Minister with a comprehensive understanding of the relevant matter.</p> <p>F2 An applicant must provide documents or information that positively demonstrate that it will satisfy each of its obligations when the market commences and on a continuing basis. Examples of such documents or information include:</p> <ul style="list-style-type: none"> (a) board certification that the applicant has systems, structures, processes and resources in place which, to the best of the board’s knowledge, are adequate to meet the applicant’s obligations on a continuing basis; (b) evidence of testing the market’s systems and processes; and (c) evidence of its planning, particularly the plan referred to in policy proposal paragraph E10. <p>Note: In Section E, we set out how we interpret some of the key obligations of market licensees and our approach to assessing a market licensee’s ongoing compliance with its obligations.</p>	<p>F2Q1 Are there any other means by which ASIC should satisfy itself about the ability of the applicant to comply with its obligations if a licence is granted?</p>

Policy proposal	Your feedback
<p>F3 We expect the applicant to certify that the information and documents provided with the application are true, correct and complete.</p> <p>How will we deal with your application?</p> <p>F4 We will aim to provide the Minister with advice about the application within 12 weeks of receiving <i>all</i> information and documents required. The 12-week period does not include time during which we are waiting for you to respond to a request for more information. If the application requires consultation with the public, this will normally take a further 6 weeks.</p> <p>F5 We will return any application that does not contain the information and documents required by the FSR Act and the regulations.</p> <p>F6 We may request clarification or explanation of the information or documents provided by an applicant.</p> <p>F7 We may also request that there be independent verification of a particular matter or aspect of the operation of the market. When making such a request, we will be guided by the significance of the matter to the operation of the market.</p>	<p>F3Q1 Are there any other means that we should adopt to ensure the completeness and accuracy of the application?</p>
<p>What will we consider when advising the Minister?</p> <p><i>Our general approach</i></p> <p>F8 We will normally consider the following matters when framing our advice to the Minister about granting a licence:</p> <p>(a) the law and regulations, particularly the</p>	<p>F8Q1 Are there any other matters we should consider, and if so, what are they?</p>

Policy proposal	Your feedback
<p>matters in s795B and 798A;</p> <p>(b) how the regulatory outcomes identified in Table A will be achieved in the market's operation; and</p> <p>(c) what conditions might need to be imposed on a market licence.</p> <p><i>Licence conditions</i></p> <p>F9 In our advice to the Minister, we will include suggestions about the conditions on the market licence, including whether there should be additional conditions on the licence:</p> <p>(a) if additional conditions are needed to ensure that a regulatory outcome is achieved, for example:</p> <p>(i) a condition requiring the licensee to provide a risk disclosure statement to each new participant on the market about particular risks associated with the market; or</p> <p>(ii) conditions dealing with other markets or financial services provided by the licensee, so as to minimise the effect of any failure in that other activity on the licensee's role as operator of the market the subject of the application; or</p> <p>(b) as a mechanism to ensure compliance with a licensee's obligations, for example a condition requiring the appointment of a person to perform a particular role in relation to the market (such as supervisor).</p> <p>F10 We will consult with the applicant about the type of conditions we may recommend before we give our advice to the Minister about the application.</p>	<p>F9Q1 Is any guidance needed about the mandatory conditions referred to in s796A(4)? If so, what should it be?</p>

Policy proposal

Your feedback

Clearing and settlement

F11 We will advise the Minister that the applicant should have clearing and settlement arrangements if:

- (a) concluded contracts are made through the market facilities; and
- (b) parties to contracts do not know in advance the identity of the person with whom they contract.

F12 We may also advise the Minister that clearing and settlement arrangements are necessary in other circumstances, particularly where there are retail market users.

F13 We will consider the following factors in deciding whether to advise the Minister that the applicant's clearing and settlement arrangements should be provided by a CS facility licensee:

- (a) the arrangements will be provided by a person other than a participant or an agent of a participant in the market;
- (b) the size and sophistication of the market, including whether there are retail market users in the market;
- (c) the classes of financial products and the anticipated volume of trading;
- (d) the complexity of the clearing and settlement arrangements proposed for the market, including the resources required to conduct the arrangements;

Note: For example, whether they involve novation.

- (e) the procedures for dealing with failure to settle;
- (f) the systemic risks that may arise from the arrangements; and

F13Q1 Are there any other factors that we should consider? If so, what are they?

Policy proposal

- (g) the extent to which the arrangements are otherwise regulated.

Note: For example, whether the arrangements are set out in the operating rules of the market operator.

Operating rules

F14 Operating rules are all rules, obligations or procedures determined by the market operator which are neither:

- (a) written procedures as required by the regulations; nor
- (b) other procedures which:
 - (i) do not impose substantive obligations upon any market user or participant; and
 - (ii) are made under the authority of an operating rule.

Note: For example, a form prescribed by an operating rule would not be an operating rule.

F15 Operating rules may also include rules relating to matters other than those specified in reg 7.2.07.

F16 When we review a market's operating rules as part of a licence application or when considering amendments to the rules, we will consider whether, in light of the market structure and commercial considerations, the rules:

- (a) meet the requirements of the FSR Act and regulations;
- (b) are legally effective;
- (c) are consistent with a market licensee's obligations and existing or proposed

Your feedback

F14Q1 Is there any other appropriate manner for determining what is an operating rule? If so, what is it?

F15Q1 Is any guidance needed about what additional matters would be regarded as appropriate for inclusion in the operating rules?

F16Q1 Should we consider any other factors? If so, what are they?

Policy proposal	Your feedback
<p>licence conditions;</p> <p>(d) might mean the regulatory outcomes identified in Table A are not achieved;</p> <p>(e) might undermine the policy of the law that the Minister should be able to disallow rules that are objectionable from a regulatory perspective;</p> <p>(f) can be effectively implemented, including whether the market operator has systems, structures, processes and resources to administer the rules and supervise compliance with the rules; and</p> <p>(g) are consistent with international standards in comparable regulatory regimes.</p>	
<p>Written procedures</p>	
<p>F17 If written procedures deal with matters relating to operating rules, they should only deal with administrative matters and not impose substantive obligations.</p>	<p>F17Q1 Is there any other basis to distinguish between operating rules and written procedures?</p>
<p>F18 Written procedures should be clearly identifiable as such.</p>	<p>F18Q1 Do you think that written procedures should be labelled as such? If not, how will the participants, market users and ASIC identify the written procedures?</p>
<p>What if you are already operating a market?</p>	
<p>F19 If you are a market operator approved under the old Corporations Act, you should consider whether your activity requires you to hold an Australian financial services licence or an Australian market licence. If you need an Australian market licence, you will need to review your current operation and systems in light of the market licensee</p>	

Policy proposal

obligations under the FSR Act.

Note: For guidance about when the different types of licence will be required, see the Schedule.

You may also need to see our guide on transitional provisions, *Licensing and disclosure: Making the transition to the FSR regime – An ASIC guide* (October 2001).

Your feedback

Explanation

1 An application for an Australian market licence must be made in accordance with s795A. Two types of application for an Australian market licence are specified in s795B. This paper looks at the application for an Australian market licence in s795B(1). There are separate criteria in s795B(2) for the consideration of an application for an overseas market.

What must you include with your application?

2 There is no application form for an Australian market licence. Regulations 7.2.10–7.2.12, however, specify information and documents required to be provided with an application. A prospective applicant may wish to discuss the application with us before lodging the application. We may need to request further information from the applicant.

3 An applicant for a licence must provide ASIC with a range of information and documents, which are aimed at satisfying us that the applicant has the skills, expertise, procedures and capacity to meet its obligations under the licence, given its organisation and business activities. The information and documents required will vary depending on the nature of the market.

4 At the application stage, it will generally be difficult to demonstrate the adequacy of the supervisory arrangements for a market, as those arrangements will be untested. This makes it essential for the applicant to plan, in detail, how it will comply with its obligations to have adequate arrangements to supervise the market as required under s792A(c). In order to demonstrate the necessary level of planning, we think an applicant should provide us with a plan of the type referred to in policy proposal paragraph E10. The plan should set out in detail the applicant's arrangements, for at least the forthcoming year, for supervising the market, including how the adequacy of those arrangements will be monitored and assessed. The plan should deal with each of the matters referred to in s792A(c), namely:

- (a) handling conflicts;
- (b) monitoring the conduct of participants on or in relation to the market; and
- (c) enforcing compliance with the operating rules.

How will we deal with your application?

5 The significance of particular matters in relation to the operation of the market means that we may, in certain cases, also require independent verification by a suitably qualified third party of the status of the relevant matter. The verification would be provided to us by the applicant at its own cost. For example, a computer specialist may need to verify the operation of the technology to be used in the facility.

6 We will determine on a case-by-case basis when we need independent verification, guided by the significance of the matter to the operation of the market. We will discuss the need for independent verification with the applicant as part of our review of the application. Our main focus on independent verification will be on the technology to be used in the facility and the resources of the applicant.

What will we consider when advising the Minister?

7 When advising the Minister, we will consider the matters outlined in policy proposal paragraph F8. The Minister must give consideration to specific matters in s798A(2) that relate to the characteristics of the market. It is also necessary to give particular consideration to the conditions under which the market should operate.

Licence conditions

8 A significant change from the old Corporations Act is the power of the Minister to impose conditions when issuing a licence. The Minister's ability to impose conditions on a market licence is a key component to providing flexibility in the administration of the market provisions. We will give advice to the Minister about the conditions that we think should apply to the market licensee.

9 Section 796A(3) stipulates when licence conditions can be imposed. We think that additional conditions should not be imposed on every market licensee. However, we will consider advising the Minister to impose additional conditions if they are necessary to achieve the regulatory outcomes we have identified in Table A. We also think that conditions may be used as a mechanism to ensure compliance with an obligation. For example, we may require that there be an external supervisor for a market, if the market licensee is not able to satisfactorily supervise the market.

10 A licence will be subject to mandatory conditions, set out in s796A(4), which specify:

- (a) the particular market that is licensed;
- (b) the class or classes of financial product that can be dealt with on the market; and
- (c) the type of clearing and settlement arrangements, where the Minister considers that the licensee should have clearing and settlement arrangements. (For our approach to clearing and settlement arrangements, see policy proposal paragraphs F11 and F13.)

If compensation arrangements under Division 3 of Part 7.5 are required, there will also be mandatory conditions under s882A(4) or 882B(4)(b) setting out the minimum amount of cover and the source of the funds. (For our approach to adequate compensation arrangements, see policy proposal paragraphs E17 to E19.)

11 We will consult with the applicant about both the mandatory conditions and any additional conditions that we consider should be imposed by the Minister.

12 Transitional provisions will deal with the position of the existing market operators. We will continue to discuss with those market operators the market that they conduct as part of the licensing process.

Clearing and settlement

13 The legislation differentiates between mechanisms that can be used for clearing and settlement. There are two types of mechanisms:

- (a) clearing and settlement arrangements; and
- (b) clearing and settlement facilities.

14 Clearing and settlement arrangements are defined in s790A. They are arrangements for the clearing and settlement of transactions. These may or may not be provided by a CS facility licensee. Clearing and settlement facility is defined in s768A and reg 7.1.05 and 7.1.06. A clearing and settlement facility must be provided by a CS facility licensee.

Clearing and settlement arrangements

15 The Minister must decide when a market should have clearing and settlement arrangements. We will advise the Minister that clearing and settlement arrangements are required for anonymous

markets. (A market is anonymous if concluded contracts are made through the market facilities and the parties to the contract do not know the identity of the person with whom they contract in advance.) Without clearing and settlement arrangements, people trading on an anonymous market would not be able to achieve efficient settlement of transactions. Without efficient settlement processes, a market will not be orderly.

16 Clearing and settlement arrangements may be appropriate in other circumstances. For example, it may be appropriate that clearing and settlement arrangements be established by, or be within, the operating rules of the market operator, if the market has retail market users.

Clearing and settlement facilities

17 There is no clear means of differentiating when a clearing and settlement arrangement is required and when a clearing and settlement facility, provided by a CS facility licensee, is required. The approach that we propose identifies circumstances and factors that we think are relevant to determining when the more regulated clearing and settlement facility must be in place.

18 The factors that we think are relevant revolve around the complexity of the arrangements and likely size of the market.

Operating rules

19 Effective operating rules are essential for a fair, orderly and transparent market and we will consider them in detail when reviewing a licence application.

20 Operating rules, as defined in s761A, are any rules, including the listing rules of a market (if any), that are made by the applicant or the market licensee or contained in the constitution of those entities and deal with:

- (a) the activities or conduct of the market; or
- (b) the activities or conduct of persons in relation to the market,

but it excludes:

- (c) written procedures as prescribed by s793A(2); or
- (d) compensation rules, being rules relating to the compensation arrangements for a market.

21 The minimum content of the operating rules is specified in reg 7.2.07: see Revised Explanatory Memorandum, paragraph 7.77.

22 The FSR Act reinforces the importance of operating rules by requiring them to be considered when a market application is made and by providing that a change to a rule be subject to the power of the Minister to disallow the amendment: see s793D and 793E.

23 The FSR Act also provides that the operating rules have effect as a contract under seal: s793B. A range of persons, including a person aggrieved by a failure to comply with the rules, may take action to enforce the operating rules: s793C.

24 The FSR Act provides an overriding principle to be applied when the rules are being considered, namely, whether the rules ensure that the market is fair, orderly and transparent. When we advise the Minister about a market operating rule, we will consider the rule in the context of the commercial activities of the market operator and the existing market, and whether the rule meets the standard outlined in policy proposal paragraph F16.

25 A rule that gives a market licensee a general power to waive other rules means that the market licensee may effectively amend the rules, without requiring the amendment to be considered by the Minister in accordance with s793E. We think that such a rule undermines the policy of the law that the Minister consider amendments to operating rules.

26 The effectiveness of an operating rule is related to the manner in which the rules are administered. We think that we should make enquiry about the means by which the rules will be administered and supervised when considering the operating rules.

27 Most markets also have a range of procedures and guidance notes. It is important that there be a clear understanding of which procedures and guidance notes, if any, are in fact operating rules. Failure to lodge a change to an operating rule has a significant consequence, in that the change ceases to have effect at the end of the 21-day period allowed for lodging the rule with us.

28 We recognise that not all obligations imposed by a market licensee are operating rules, so we think it is important to indicate the matters that we do not consider to be operating rules. Our proposed test focuses on whether a substantive obligation is imposed by the rule, in which case it should be regarded as an operating rule.

Written procedures

29 The FSR Act distinguishes between operating rules and written procedures. Regulation 7.2.08 prescribes the content of written

procedures. The Revised Explanatory Memorandum recognises that there may be matters in the written procedures in addition to those prescribed by the regulation: see paragraph 7.77.

30 Generally, the written procedures will not impose substantive obligations on participants or users. Substantive obligations should be contained in the operating rules so as to ensure that they are legally binding and subject to ministerial disallowance. We would expect the written procedures to operate as explanation, detailing processes and arrangements, and amplifying the operating rules.

What if you are already operating a market?

31 For existing market operators, the transitional provisions will be relevant to the need for a licence and the conditions to be imposed on that licence. There is also a question whether persons currently operating some types of market will still be required to hold a market licence. On some markets currently operated under exempt futures market declarations, participants deal principal to principal and enter into individually negotiated contracts. These markets may involve conduct that is regulated under the financial services provisions, as market making.

32 If you are approved under the old Corporations Act, you will have current systems that you rely on to meet your obligations under the old Corporations Act. You will need to review those systems in light of the licensee obligations under the FSR Act and this policy proposal paper before you apply for a licence under the FSR Act.

Schedule: What types of activities will require an Australian market licence?

The examples set out below illustrate how to use the policy proposals in this paper to work out whether various kinds of activities can only be engaged in if the relevant operator holds an Australian market licence.

The examples relate to:

- 1 Order routing systems
- 2 Internet portal operators
- 3 Electronic trading services
- 4 Cross-border trading screens

Question

SQ1 Are there any other important activities on which guidance is needed? If so, what are those activities and why are they important?

1 Order routing systems

Consider the following example:

- (a) A company, registered under Chapter 2A of the Corporations Act, operates an electronic service that allows persons to enter offers or invitations for acquisition or disposal of financial products;
- (b) The electronic service transmits or routes those offers or invitations to another person who forwards them to a financial market, not operated by the company, for quotation or execution; and
- (c) The electronic service does not perform any function other than transmitting or routing the offers or invitations. In particular, offers or invitations are not altered in any way before they are transmitted to the financial market. (However, the offers or invitations may be aggregated and/or filtered. If the filters detect any problems, the offer or invitation is either returned to the person who placed it or otherwise diverted from the service.)

Question: Does the company require an Australian market licence?

Does the company operate a financial market?	<p>The facility operated by the company is not one through which offers or invitations are made.</p> <p>The offers and invitations are <i>made</i> when they are received by the person to whom the offer or invitation is made or by his or her agent. The offers or invitations are received on the financial market to which the order routing system routes them, not on the order routing system. See policy proposal paragraph B7.</p> <p>Offers or invitations are not made <i>through</i> a facility merely because that facility is a step in the process that results in the eventual making of the offer or invitation. See policy proposal paragraph B4.</p> <p>The company is not operating a financial market.</p>
--	--

Conclusion: On these facts alone, the company does not require an Australian market licence.

2 Internet portal operators

EXAMPLE A

Consider the following example:

- (a) A company, registered under Chapter 2A of the Corporations Act, operates a financial services website;
- (b) Various licensed advisers, brokers, fund managers and market operators advertise their services on the company's site;
- (c) On entering the site, viewers see a prominent disclaimer stating that the company does not in any way endorse any services or markets that may be accessed through the site;
- (d) Viewers can click on links that take them from the company's site to other websites, some of which are operated by Australian market licensees and provide access to licensed markets and some of which are operated by foreign companies and provide access to markets which are not licensed under Australian law;
- (e) The company receives remuneration from linked sites based on the number of viewers who use the relevant link;
- (f) When viewers activate a link to another website, they immediately see a pop-up box telling them they are leaving the company's site. Similarly, when returning to the company's site, viewers see a pop-up box telling them they are entering the company's site; and
- (g) The company does not endorse, select, modify or exercise control over the content of material on its website, except that it retains the right to remove, or refuse to transmit, material it considers may be illegal or defamatory.

Question: Does the company require an Australian market licence?

Does the company operate a financial market?

The facility operated by the company is not one through which offers or invitations are made.

The offers and invitations are *made* when they are received by the person to whom the offer or invitation is made or by his or her agent. The offers or invitations are received on the financial markets which are accessed through the Internet portal operated by the company. **See policy proposal paragraph B7.**

Offers or invitations are not made *through* a facility, such as an Internet portal, merely because that facility is a step in the process that results in the eventual making of the offer or invitation. **See policy proposal paragraph B4.**

The company is not operating a financial market.

Conclusion: On these facts alone, the company does not require an Australian market licence.

2 Internet portal operators (continued)

EXAMPLE B

Consider the following example:

- (a) A company, registered under Chapter 2A of the Corporations Act, operates a financial services facility, including a website;
- (b) Various licensed dealers indicate their willingness to deal in certain financial products and/or firm prices for financial products on the company’s website;
- (c) Investors viewing the site may submit, using the facility, a price enquiry on a financial product listed on the site. The investor’s price enquiry and contact details are then forwarded to all dealers in the facility who have indicated their willingness to deal in the relevant financial product. Any dealer may then contact the investor and negotiations take place between the dealer and investor;
- (d) Alternatively, investors viewing the site can click on a dealer’s firm price posted on the site. The dealer is then notified of the investor’s interest and can contact the investor to negotiate a contract; and
- (e) In both the situations described in paragraph (c) and (d) contracts are negotiated directly between the investor and the dealer and the dealer is entitled to withdraw offers or invitations made through the website if not satisfied about the ability of the investor to settle the transaction.

Question: Does the company require an Australian market licence?

Does the company operate a financial market?	<p>The facility operated by the company is one through which offers or invitations are made.</p> <p>At a minimum, the communications made on the facility are requests to enter into a course of negotiations with a view to entering into a binding contract. They identify persons who are likely to acquire or dispose of financial products and the prices at which those persons are likely to acquire or dispose of a financial product. See policy proposal paragraphs B5 and B6.</p> <p>The company is operating a financial market.</p>
Does the company operate that market in this jurisdiction?	<p>The market is operated in this jurisdiction because the company is registered under Chapter 2A of the Corporations Act. See s791D(1).</p>
Will the market be exempted from the operation of Part 7.2?	<p>We will not advise that the market be exempted from the operation of Part 7.2. The market requires regulation as a financial market in order to achieve the outcomes in Table A. See policy proposal paragraph D2.</p>

Conclusion: On these facts alone, the company requires an Australian market licence.

3 Electronic trading services

EXAMPLE A

Consider the following example:

- (a) A company, registered under Chapter 2A of the Corporations Act, operates an electronic trading service;
- (b) The company is a participant of a market that is licensed under Part 7.2;
- (c) The operation of the electronic trading service complies with the operating rules of the licensed market and is supervised by the operator of that licensed market;
- (d) The electronic trading service allows users to trade in specific securities, all of which are listed on the licensed market;
- (e) The electronic trading service allows users to anonymously display bid and offer prices and order sizes in the relevant securities;
- (f) The electronic trading service executes orders against orders received from other users of the electronic trading service; and
- (g) The dollar value trading volume of trades executed on the electronic trading service in any particular security does not exceed 10% of the total for that security.

Question: Does the company require an Australian market licence?

Does the company operate a financial market?	The company operates a financial market: the electronic trading service is a facility through which offers to acquire or dispose of financial products are regularly made and accepted.
Does the company operate that market in this jurisdiction?	The market is operated in this jurisdiction because the company is registered under Chapter 2A of the Corporations Act. See s791D(1).
Will the market be exempted from the operation of Part 7.2?	<p>We will advise the Minister that the market operated by the company should be exempted from the operation of Part 7.2. The market is subject to other forms of regulation which are sufficient to achieve the outcomes in Table A. See policy proposal paragraph D2.</p> <p>The other forms of regulation to which the market operated by the company is subject are:</p> <ul style="list-style-type: none"> (a) regulation by the operator of the licensed market referred to in paragraph (c) above; and (b) regulation of the company under Part 7.6 of the FSR Act (financial service providers).

Conclusion: On these facts alone, we will advise the Minister to exempt the market from the operation of Part 7.2.

3 Electronic trading services (continued)

EXAMPLE B

Consider the following example:

- (a) Paragraphs (a) to (f) of Example A apply; and
- (b) The dollar value trading volume of trades executed on the electronic trading service in a particular security exceeds 50% of the total for that security.

Question: Does the company require an Australian market licence?

Does the company operate a financial market?	The company operates a financial market: the electronic trading service is a facility through which offers to acquire or dispose of financial products are regularly made and accepted.
Does the company operate that market in this jurisdiction?	The market is operated in this jurisdiction because the company is registered under Chapter 2A of the Corporations Act. See s791D(1).
Will the market be exempted from the operation of Part 7.2?	We will not advise that the market be exempted from the operation of Part 7.2. In light of the volume of trading on the electronic trading service, regulation of the company by the licensed market operator and under Part 7.6 of the FSR Act is insufficient to achieve the outcomes in Table A. See policy proposal paragraph D2.

Conclusion: On these facts alone, the company requires an Australian market licence.

3 Electronic trading services (cont)

EXAMPLE C

Consider the following example:

- (a) A company, incorporated under the law of a foreign jurisdiction, operates an electronic trading service through the Internet;
- (b) The electronic trading service allows users to trade in specific securities, none of which are listed on an Australian licensed market;
- (c) The electronic trading service allows users to anonymously display bid and offer prices and order sizes in the relevant securities;
- (d) The electronic trading service executes orders against orders received from other users of the electronic trading service;
- (f) On entering the site, viewers see a prominent, and true, statement that the market is regulated by the law of the foreign jurisdiction and may only be used by residents of that jurisdiction;
- (g) Prices on the market are not denominated in Australian dollars; and
- (h) The operator screens offers sent from Australian addresses but 5 Australian investors have purchased securities on the market in the last year.

Question: Does the company require an Australian market licence?

Does the company operate a financial market?	The company operates a financial market: the electronic trading service is a facility through which offers to acquire or dispose of financial products are regularly made and accepted.
Does the company operate that market in this jurisdiction?	<p>The market is not operated in Australia:</p> <ul style="list-style-type: none"> (a) the operator of the market is not a body corporate registered under Chapter 2A of the Corporations Act; (b) the market is not located in Australia; and (c) although a person in Australia has unintermediated access to the market, the operator of the market does not target Australian investors. See policy proposal paragraph C1. <p>When taken as a whole the facts and circumstances pertaining to the market indicate that the operator has not targeted Australian investors, even though Australian investors have used the market. See policy proposal paragraph C4 and C5.</p>

Conclusion: On these facts alone, the company does not require an Australian market licence.

4 Cross-border trading screens

Consider the following example:

- (a) A company, incorporated under the law of a foreign jurisdiction, operates a securities market that is regulated in that jurisdiction;
- (b) The exchange has a proprietary automated trading system that permits broker-dealers to enter orders and effect trades on-screen, via computers located in their offices;
- (c) The computers are connected to the automated trading system of the exchange through secure remote access; and
- (d) A broker-dealer located in Australia has direct access to the exchange's automated trading via a computer in its office in Australia and uses it to directly enter offers and execute trades on the exchange.

Question: Does the company require an Australian market licence?

Does the company operate a financial market?	The company operates a financial market: it operates a facility on which offers to acquire or dispose of securities are regularly made and accepted.
Does the company operate that market in this jurisdiction?	<p>The market operates in Australia because it is located in Australia. See policy proposal paragraph C2.</p> <p>It is also likely that the market operates in Australia because a person in Australia has unintermediated access to the market and its operator targets Australian investors. See policy proposal paragraph C1.</p> <p>The fact that the market also operates in another jurisdiction does not preclude the conclusion that it operates in Australia.</p>
Will the market be exempted from the operation of Part 7.2?	Although the market is regulated by the laws of a foreign jurisdiction, ASIC will not advise that the market be exempted from Part 7.2. See policy proposal paragraph D3.

Conclusion: On these facts alone, the company requires an Australian market licence.

Regulatory and financial impact

ASIC plays a secondary role in financial market regulation. The Minister grants licences and exemptions, imposes conditions on licences, revokes licences and disallows changes to operating rules. ASIC's main role is to advise the Minister and enforce the FSR Act. We have considered the likely regulatory and financial impact of the policy proposals in this paper against this background.

Based on the information that we currently have, we believe that our proposals strike an appropriate balance between facilitating financial services activity and investor protection. To ensure that we have achieved an appropriate balance, we are also developing a Regulatory and Financial Impact Statement (RIS).

The RIS will address the following seven key elements:

1 Issue / problem

This will discuss the nature and magnitude of the problem.

2 Objective(s) / analysis of the problem

The objective(s), or the outcome sought in relation to the identified issue / problem, will be addressed.

3 Options / solutions

This will identify all the alternative options that could achieve the objective(s) stated above for dealing with the issue being considered (eg no specific action; ASIC policy proposal; media release; information statement; self regulation/quasi regulation; codes of conduct; and co-regulation, compliance and enforcement strategies).

4 Impact analysis (costs and benefits) of each option

Impact analysis will include:

- (a) analysis of the benefits and costs of the options, including any restriction on competition for different persons affected;
- (b) identification of persons or bodies affected by the problem; and those that will be affected by the solutions or options identified (ie applicant/proponent of issue; other interested parties, consumers, business and government);

- (c) a consideration of how each of the proposed options will affect existing law, regulations or policies;
- (d) identification and categorization of the expected impacts of the proposed options as likely benefits or likely costs against each of the persons/bodies identified as likely to be affected;

We will try to quantify these effects where possible (for example, will there be any restriction on competition as a result of the proposed regulation?)

Costs to business affected by a regulatory initiative might include: administrative costs; complying with new regulatory standards; licence fees; delays etc.

Costs to consumers affected could also include higher prices for goods and services; reduced utility of goods and services; delays and more difficult or expensive options for seeking redress.

- (e) benefits of the options will also be identified (even where they are not quantifiable); and
- (f) the data sources used and assumptions made in making these assessments will be identified.

5 Consultation

The consultation undertaken in the policy process will be detailed.

6 Conclusions and recommended option

The preferred option(s) will be given, and reasons why.

7 Implementation and review

This will discuss how the proposed option will be administered, implemented, or enforced, (eg instrument of relief; policy statement; practice note; no action letter).

In order for us to fully assess the financial and regulatory impact of our proposals, we invite you to consider possible options that would achieve our objectives, comment on the impact that these policy proposals might have, and in particular, give consideration to the costs and benefits of these proposals. Where possible, we are seeking both quantitative and qualitative data.

Any comments that we receive will be taken into account when preparing our final RIS.

Development of policy proposal

We have developed this policy proposal paper by considering:

- (a) the intention of the FSR Act as indicated in the Revised Explanatory Memorandum and the Second Reading Speech in the House of Representatives;
- (b) the Report on the Financial Services Reform Bill by the Parliamentary Joint Committee on Corporations and Securities issued in August 2000;
- (c) the Government's response to the Report, issued on 29 March 2001;
- (d) relevant comparisons with current legislative requirements for the regulation of financial services activity under the law;
- (e) a review of existing ASIC policies and practices relevant to the regulation of financial services activity under the law; and
- (f) a review of public submissions on the Exposure Draft Bill issued by the Government in February 2000.

Compliance measures

In developing the policy and guidance on monitoring and supervision, we have drawn on our experience in licensing and compliance across a range of industries and industry participants. We have also had regard to Australian Standard 3806–1998 on Compliance Programs, which sets out the essential structural, operational and maintenance elements of an effective compliance program.

Risk

In developing our approach to outcomes we have given consideration to approaches to risk management. We have considered numerous domestic and international approaches to risk when developing these policy proposals, including:

- (a) the Australian/New Zealand Standard on Risk Management;
- (b) the Financial Services Authority (UK) approach;

- (c) the International Organisation of Securities Commissions approach; and
- (d) processes developed as part of the managed investment implementation program.

Key terms

In this policy proposal:

“ASIC” means the Australian Securities and Investments Commission;

“Corporations Act” means the *Corporations Act 2001* and includes regulations made for the purposes of that Act;

“CS facility licensee” means a person who holds an Australian CS facility licence;

Note: This is a definition contained in s761A of the FSR Act.

“financial product” has the meaning given by Division 3 of Part 7.1 of the FSR Act;

Note: This is a definition contained in s761A of the FSR Act.

“FSR Act” means the *Financial Services Reform Act 2001*, or the Corporations Act as amended by the FSR Act, as applicable, and includes regulations made for the purposes of the FSR Act;

Note: The provisions contained in Schedule 1 to the FSR Act will form part of the Corporations Act from 11 March 2002. Schedule 1 contains the financial market licensing provisions under Part 7.2.

“FSR commencement” means 11 March 2002, the date fixed by Proclamation under s2(2) of the FSR Act on which Schedule 1 of the FSR Act is to commence.

Note: Schedule 1 contains the financial market licensing provisions under Part 7.2.

“intermediary” means a participant in a financial market that acquires or disposes of financial products in that market as agent for another person;

“licence” means an Australian market licence under s795B that authorises a person to operate a financial market, unless a contrary intention appears;

“licensee obligations” means the obligations of a market licensee as set out in Subdivision A of Division 3 of Part 7.2 of the FSR Act;

“market licensee” means a person who holds an Australian market licence;

Note: This is a definition contained in s761A.

“market users” means investors who acquire or dispose of financial products in a financial market. Investors may be participants dealing for themselves or, where participants act as intermediaries, the clients of the participants;

“old Corporations Act” means the Corporations Act as in force immediately before FSR commencement;

“participant” means a person who is allowed to directly participate, in the market under the market’s operating rules.

Note: This is a definition contained in s761A of the FSR Act.

“reg 7.2.10”, for example, means a regulation in the *Corporations Amendment Regulations 2001 (No 4)*;

“retail client” has the meaning given by s761G;

Note: This is a definition contained in s761A of the FSR Act.

“regulatory outcomes” means the outcomes identified in Table A of Section A “Our role in financial market regulation”;

“Revised Explanatory Memorandum” means the revised explanatory memorandum to the *Financial Services Reform Bill 2001* that takes account of amendments by the House of Representatives made on 28 June 2001 to the Bill as introduced;

“PS 136”, for example, means an ASIC Policy Statement (in this example numbered 136);

“Supplementary Explanatory Memorandum” means the supplementary explanatory memorandum to the amendments and new clauses to be moved in the Senate on behalf of the Government to the *Financial Services Reform Bill 2001* as amended by the House of Representatives on 28 June 2001; and

“s782”, for example, refers to a provision of the Corporations Act after FSR commencement, unless a contrary intention appears.

What will happen next?

Stage 1

2 November 2001 ASIC policy proposal paper released

Stage 2

November 2001 Consultation period on the contents of this policy proposal paper

30 November 2001 Comments due on the policy proposal

December 2001 Drafting of policy statement

Stage 3

Early February 2002 Policy statement released

Your comments

You are invited to comment on the proposals and issues for consideration in this paper.

Comments are due by Friday, 30 November 2001 and should be sent to:

Roxanna Irvin
FSR Project Office
Regulatory Policy Branch
Australian Securities & Investments Commission
GPO Box 4866
Sydney NSW 1042
email: FSRProjectOffice@asic.gov.au

You can also contact the ASIC Infoline on 1300 300 630 for information and assistance.

Related papers

This policy proposal paper is one of a set of papers on the implementation of the *Financial Services Reform Act 2001*.

As outlined in our paper *Building the FSRB Administrative Framework*, we issued earlier publications in April, June, September and October 2001. Further publications may be issued on the implementation of the FSR Act.

The related documents issued together in April are:

Building the FSRB Administrative Framework – Policy to implement the Financial Services Reform Bill 2001 (the April 2001 Framework document)

Licensing: The scope of the licensing regime: Financial product advice and dealing
FSRB Policy Proposal Paper No 1

Licensing: Organisational capacities
FSRB Policy Proposal Paper No 2

Licensing: Adapting IPS 146 to the Financial Services Reform regime
FSRB Policy Proposal Paper No 3

Disclosure: Product Disclosure Statements (and other disclosure obligations)
FSRB Policy Proposal Paper No 4

Disclosure: Discretionary powers and transition
FSRB Policy Proposal Paper No 5

Licensing process guideline: How do you get an Australian financial services (AFS) licence? (Release 1.0)

The related documents issued together in June are:

Licensing: Principles and representatives
FSRB Policy Proposal Paper No 6

Licensing: External and internal dispute resolution
FSRB Policy Proposal Paper No 7

Licensing: Discretionary powers
FSRB Policy Proposal Paper No 8

Approval of codes
FSRB Policy Proposal Paper No 9

The related documents issued in September are:

Supplement to the April 2001 Framework document

Licensing: Financial requirements
FSRB Policy Proposal Paper No 10

The related documents issued together in October are:

Licensing and disclosure: Making the transition to the FSR regime – An ASIC guide

Licensing process guideline: *How do you get an Australian financial services (AFS) licence? (Release 2.0)*

Copies of policy proposal papers

Download them from the ASIC home page:

<http://www.asic.gov.au>

(follow the links from “Financial services reform” that is on the top right of our home page)

You can also get copies of ASIC policy proposal papers from: ASIC Infoline: 1300 300 630

To find out more about FSR

Visit the FSR page on our website at www.asic.gov.au:

- (a) click “Financial services reform” on the top right of our home page
- (b) register for our free update email service which alerts you to our latest developments.