

**Australia: IOSCO Objectives and Principles of Securities Regulation—
Detailed Assessment of Implementation**

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AUSTRALIA

IOSCO OBJECTIVES AND PRINCIPLES OF SECURITIES
REGULATION

DETAILED ASSESSMENT OF IMPLEMENTATION

NOVEMBER 2012

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GLOSSARY

AASB	Australian Accounting Standards Board
ACCC	Australian Competition and Consumer Commission
AFSL	Australian Financial Services License
AG	Attorney-General
AIMA	Alternative Investment Management Association
AML	Australian Markets License
APESB	Accounting Professional and Ethical Standards Board
APRA	Australian Prudential Regulation Authority
ASIC	Australian Securities and Investments Commission
ASLF	Adjusted Surplus Liquid Funds
ASX	Australian Stock Exchange Group
AUASB	Australian Auditing and Assurance Standards Board
AUSTRAC	Australian Transaction Reports and Analysis Centre
CA	Corporations Act 2001
CALB	Companies Auditors and Liquidators Disciplinary Board
CARI	Consumers, Advisers and Retail Investors Stakeholder Team
CDPP	Commonwealth Director of Public Prosecutions
CFR	Council of Financial Regulators
CIS	Collective Investment Scheme
COR	Corporations Stakeholder Team
CR	Corporations Regulations
CRA	Credit Rating Agency
CSFL	Clearing and Settlement Facility License
DBOR	Daily Beneficial Ownership Report
EMO	Exchange Market Operators Stakeholder Team
EMR	Emerging Risk Committee
FRA	Financial Reporting and Audit Stakeholder Team
FRC	Financial Reporting Council
FSAP	Financial Sector Assessment Program
FSS	Financial Stability Standards
IAASB	International Auditing and Assurance Standards Board
IB	Investment Banks Stakeholder Team
ICR	International Cooperation Requests Team
IFRS	International Financial Reporting Standards
IMS	Investment Managers and Superannuation Stakeholder Team
ISA	International Auditing Standards
IOSCO	International Organization of Securities Commissions
ISG	Intermarket Surveillance Group
MABRA	Mutual Assistance in Business Regulation Act 1992
MACMA	Mutual Assistance in Criminal Matters Act 1987
MIR	Market Integrity Rules

MIS	Managed Investment Schemes
MPS	Market and Participants Supervision Stakeholder Team
NGF	National Guarantee Fund
RBA	Reserve Bank of Australia
RE	Responsible Entities
RG	Regulatory Guide
RIA	Regulatory Impact Analysis
RIS	Regulatory Impact Statement
STEL	Stress-test Exposure Limit
TIA	Telecommunications (Interception and Access) Act 1979

I. SUMMARY

1. **The Australian legal and regulatory framework for securities markets exhibits a high level of compliance with the International Organization of Securities Commissions (IOSCO) Principles.** A few remaining concerns need to be resolved, including some identified in the 2006 assessment. Australian Securities and Investments Commission's (ASIC) operational independence and sufficiency of resources are overarching concerns which impair its ability to discharge its supervisory functions adequately and effectively across the entire regulated population.
2. **Despite being primarily a market conduct regulator, ASIC is also responsible for the overall supervision of a significant number of market intermediaries.** This includes monitoring their compliance with obligations of a prudential nature, including those relating to capital requirements and risk management. This requires ASIC to remain alert to the prudential regulatory challenges it faces.
3. **Improvements are needed in the capital adequacy requirements to improve the manner they address the risks to which various types of intermediaries are subject.** With regards to other risks, ASIC has reacted to the need to focus on systemic and emerging risks in securities markets. It is important to continue to further develop the work of the Emerging Risk Committee (ERC) and to ensure that potential important findings relating to securities markets and its participants are appropriately channeled for discussion at the Council of Financial Regulators (CFR).
4. **ASIC shares its regulatory responsibility for Clearing Participants with Australian Stock Exchange Group (ASX) that sets and monitors their capital requirements.** Australian Prudential Regulation Authority's (APRA) role in their supervision is very limited, even though it is the primary prudential regulator in Australia. The splitting of prudential supervisory responsibilities emphasizes the need for close cooperation, which is currently undertaken through the CFR and bilaterally. However, there seems to be a need to assess whether the current regulatory structure is best suited to respond to the present and future challenges.
5. **ASIC is an enforcement focused regulator.** In recent years, its reputation as an effective and credible enforcer of market regulation and corporate law has been enhanced through a series of high profile and successful prosecutions. It is less focused on ongoing, proactive supervision, which is an area that requires increased attention to complement the current enforcement efforts and to add to their deterrent effect.
6. **ASIC prioritizes cooperation and information sharing with regulators in other jurisdictions.** Current legislation is hampering its efforts here as the focus globally moves to cooperation on supervisory as well as enforcement matters. The Government is progressing amendments to the relevant law and regulations expected to be in place by late 2012 that are

intended to remove at least some of the existing restrictions and bolster ASIC's capacity for international regulatory cooperation on supervisory matters.

7. **There is a good level of protection of shareholders in Australia and accounting and auditing standards are high.** Australia devotes considerable resources to ensure that its standards and their application and enforcement continue to match best global practice and to influence global developments.

8. **The regulatory framework and supervisory practices for collective investment schemes need to be improved to comply with the IOSCO Principles.** ASIC has recently expanded its supervisory activities on hedge funds, but is constrained by lack of powers on wholesale hedge funds and on cross-border supervisory cooperation. It is also improving the coverage of its risk-based supervisory approach applicable to market intermediaries; however, ASIC's supervisory program would benefit from further expansion and uniform prioritization across the organization.

9. **The opening of Australia's securities markets to competition in the provision of execution venues has been the catalyst for significant changes in market regulation.** ASIC has taken over many of the key responsibilities for market oversight and the regulation and supervision of non-clearing participants from ASX and other smaller domestic market operators. This has brought some changes to its rule writing powers and funding arrangements.

10. **Banking, insurance, and securities regulators both in Australia and globally continue to face significant regulatory challenges in the increasingly complex markets.** New risks can arise in areas that have traditionally been considered to be of low risk. Against this background, it is important to remain alert to the evolving risks and, if needed, adjust the regulatory priorities and responsibilities accordingly to ensure an optimal structure. A key element in this is monitoring developments on the basis of timely, comprehensive, and robust data.

II. INTRODUCTION

11. **An assessment of the level of implementation of the IOSCO Principles in Australia was conducted from April 23 to May 11, 2012 as part of the Financial Sector Assessment Program (FSAP) by Eija Holttinen, Monetary and Capital Markets Department (MCM), and Richard Britton, MCM expert.** An initial IOSCO assessment was conducted in 2006. At that time, several weaknesses in the scope and effectiveness of securities market regulation were identified. Since then, ASIC has undergone a major structural reorganization intended, among other objectives, to bring staff closer to those they supervise so as to enable them to understand the businesses better and to promote a positive approach to compliance among the various classes of stakeholders.

III. INFORMATION AND METHODOLOGY USED FOR ASSESSMENT

12. **The assessment was conducted based on the IOSCO Principles and Objectives of Securities Regulation approved in 2010 and the Methodology updated in 2011.** As has been the standard practice, Principle 38 was not assessed due to the existence of separate standards for securities settlement systems and central counterparties.

13. **The IOSCO methodology requires that assessors not only look at the legal and regulatory framework in place, but also at how it has been implemented in practice.** The ongoing global financial crisis has reinforced the need for assessors to take a critical look at, and to make a judgment about supervisory practices, and to determine whether they are effective enough. Among others, such a judgment involves a review of the inspection programs for different types of supervised entities, the cycle, scope, and quality of inspections as well as how the agency follows up on findings, including by using enforcement actions.

14. **The assessors relied on:** (i) an extensive self-assessment prepared by ASIC staff, which included detailed descriptions on the legal basis for the exercise of ASIC's powers; (ii) reviews of the relevant legislation and other documents published by ASIC and other authorities; (iii) meetings with staff from ASIC, APRA, the Reserve Bank of Australia (RBA), the Treasury, the Financial Reporting Council, the Takeovers Panel and the Commonwealth Director of Public Prosecutions; and (iv) meetings with market participants, including banks, fund managers, exchanges, Alternative Investment Management Association (AIMA), Australian Accounting Standards Board (AASB), Australian Auditing and Assurance Standards Board (AUASB), Australian Financial Markets Association, Australian Shareholders' Association, Financial Services Council and Law Council of Australia.

15. **The assessors want to thank ASIC and its staff for their full cooperation** and willingness to engage in discussions on the many complex issues covered by the Methodology. We are especially grateful to Steven Bardy and his colleagues Marian Kljakovic, Ruchi Sharma and Trudy Bannister for responding to frequent requests for more data and other information and for organizing the schedule with great efficiency and good humor.

IV. REGULATORY STRUCTURE

16. **The Australian Securities and Investments Commission (ASIC) is the corporate, markets, and financial services regulator in Australia.** It is a body corporate established under the Australian Securities and Investments Commission Act 2001 (ASIC Act). ASIC's primary role is to regulate Australian companies, financial markets, financial services, organizations and professionals who deal and advise in investments, superannuation, insurance, deposit taking and credit. The ASIC Act requires ASIC to:

- Maintain, facilitate, and improve the performance of the financial system and entities in it;
- Promote confident and informed participation by investors and consumers in the financial system;
- Administer the law effectively and with minimal procedural requirements;
- Enforce and give effect to the law;
- Receive, process, and store, efficiently and quickly, information given to ASIC; and
- Make information about companies and other bodies available to the public as soon as practicable.

17. The Australian Prudential Regulation Authority (APRA) is in charge of prudential supervision of banks, insurers and superannuation (pension) fund trustees.

Under s912A Corporations Act 2001 (CA), those Australian Financial Services License (AFSL) holders that are “bodies regulated by APRA” are waived from the requirements of the CA relating to financial, technological, and human resources and risk management, because APRA’s requirements are considered to be sufficient to address these issues. ASIC supervises all other AFSL holders, including for compliance with requirements of a prudential nature. ASX continues to have a significant role in the supervision of Clearing Participants. Despite the transfer of Market Participant supervision to ASIC in August 2010, the capital requirements of Clearing Participants are still set and monitored by ASX Clear and ASX Clear (Futures), subject to oversight of ASIC.

18. The role of ASIC, APRA, and ASX in the prudential supervision of Market and Clearing Participants and operators of retail CIS in Australia is demonstrated in the tables below. The supervision of the majority of the most important Market Participants (i.e., exchange members) is shared between ASIC and the operators of ASX Group’s clearing facilities, given that most of the Market Participants are also Clearing Participants. In contrast, APRA has a role in the prudential supervision of many of the most important operators of retail Collective Investment Scheme (CIS), i.e., Responsible Entities (REs) of Managed Investment Schemes (MIS).

Table 1. Australia: Trading Volume, Market Share, and Regulatory Status of the 20 Most Important ASX Members in 2011

Name	Equity Trades (\$bn)	% Share of Total Trades	APRA Regulation	ASX Clearing Participant Capital Requirements
UBS Securities Australia Ltd	407.4	13.85	No	Yes
Citigroup Global Markets Australia Pty Ltd	407.2	13.84	No	Yes
Deutsche Securities Australia Ltd	258.1	8.78	No	Yes
Goldman Sachs Australia Pty Ltd	235.6	8.01	No	Yes
Macquarie Securities (Australia) Ltd	224.7	7.64	Level 2	Yes
Credit Suisse Equities (Australia) Ltd	189.5	6.44	No	Yes
Morgan Stanley Australia Securities Ltd	164.4	5.59	No	Yes
Merrill Lynch Equities (Australia) Ltd	129.5	4.40	No	Yes
Commonwealth Securities Ltd	120.6	4.10	Level 2	Yes
JP Morgan Securities Australia Ltd	113.3	3.85	No	Yes
RBS Equities (Australia) Ltd	97.0	3.30	No	Yes
BBY Ltd	33.1	1.12	No	Yes
Nomura Australia Ltd	47.0	1.60	No	No ¹
Etrade Australia Securities Ltd	42.0	1.43	Level 2	Yes
Susquehanna Pacific Pty Ltd	39.3	1.34	No	No ²
Australian Investment Exchange Ltd	31.6	1.07	Level 2	Yes
Instinet Australia Pty Ltd	31.2	1.06	No	Yes
ABN AMRO Clearing Sydney Pty Ltd	30.0	1.02	No	Yes
IMC Pacific Pty Ltd	25.6	0.87	No	No ³
Macquarie Equities Ltd	24.3	0.83	Level 2	Yes
Total	2,651.4	90.14		

Source: ASIC.

¹ASIC Market Participant capital requirements.

²AFSL requirements since only principal trader.

³AFSL requirements since only principal trader.

Table 2. Australia: Funds Under Management (FUM)¹ by 20 Largest Responsible Entities on December 31, 2011

Licensee	APRA Regulated ²	Corporate Group	Wholesale FUM (\$ bn)	Retail FUM (\$ bn)	Total FUM (\$ bn)
Colonial First State Investments Ltd	RSEL	CBA	38.49	30.22	68.71
Vanguard Investments Australia Ltd	RSEL		24.42	1.26	25.68
Macquarie Investment Management Ltd	RSEL	Macquarie	10.82	7.46	18.28
Perpetual Investment Management Ltd ³	No	Perpetual	8.58	5.24	13.82
Platinum Investment Management Ltd	No			11.28	11.28
BT Funds Management Ltd	RSEL	Westpac	0.97	9.97	10.93
Schroder Investment Management Australia Ltd	No		10.68		10.68
IPAC Asset Management Ltd	L2 (NOHC)	AMP	7.19	1.31	8.50
DFA Australia Ltd	No		7.50		7.50
BlackRock Asset Management Australia Ltd	RSEL		7.32		7.32
Equity Trustees Ltd	RSEL		6.41	0.90	7.31
Advance Asset Management Ltd	L2 (ADI)	Westpac	5.42	0.74	6.16
IOOF Investment Management Ltd	RSEL	IOOF	0.24	5.87	6.11
ANZ Trustees Ltd	L2 (ADI)	ANZ		5.81	5.81
MLC Investments Ltd	L2 (ADI)	NAB	2.10	3.46	5.56
BT Investment Management (RE) Ltd	L2 (ADI)	Westpac	5.13		5.13
Fidante Partners Ltd	L2 (NOHC)	Challenger	1.29	3.73	5.02
UBS Global Asset Management (Australia) Ltd	No	UBS	4.32		4.32
Ibbotson Associates Australia Ltd	No	Morningstar	4.28		4.28
Ausbil Dexia Ltd	No	Dexia	3.78		3.78

Source: ASIC.

¹The funds under management include funds in MIS and superannuation funds. The data is not available separated between these two categories. The table therefore primarily demonstrates the number of firms among the most important fund managers where ASIC and APRA share the supervisory responsibilities and where APRA is therefore responsible for certain requirements as described in paragraph 17.

²RSEL means registered superannuation entity licensee (Level 1 regulation by APRA); L2 (ADI) means Level 2 regulation by APRA as a subsidiary of an authorized deposit-taking institution; L2 (NOHC) means Level 2 regulation by APRA as a subsidiary of a registered non-operating holding company.

³Approximately \$4 billion of total FUM is managed by a related entity, Perpetual Superannuation Ltd, which is an RSEL. This \$4 billion is retail FUM.

19. **The Reserve Bank of Australia (RBA) has responsibility for monetary policy, payment system oversight, and overall financial stability in Australia.** ASIC, APRA, the RBA, and the Australian Treasury are members of the Council of Financial Regulators (CFR). The CFR has a role in identifying and addressing regulatory overlaps and gaps, and advising the Australian Government on the adequacy of Australia's financial system architecture in light of ongoing developments. It also provides a forum for cooperation and collaboration among its members.

20. **The Australian Competition and Consumer Commission (ACCC) is responsible for administering a range of general consumer protection provisions contained in the Australian Consumer Law.** However, the consumer protection provisions in relation to financial services and credit activities have been carved out from the general jurisdiction of the ACCC and assigned to ASIC. Australian Transaction Reports and Analysis Centre (AUSTRAC) is responsible for protecting the integrity of Australia's financial system and contributing to the administration of justice in countering money laundering and the financing of terrorism.

21. **The relevant Parliamentary Minister has the main responsibility for granting the licenses and approving the rules of the holders of Australian Market License (AML) and Clearing and Settlement Facility License (CSFL).** The Minister makes these decisions on the basis of advice from ASIC. In relation to CSFL applications, the RBA assesses compliance with the Financial Stability Standards.

V. LEGAL FRAMEWORK

22. **The principal legislative acts governing the structure and conduct of securities markets and their participants are the Corporations Act 2001 and the ASIC Act 2001.** Market intermediaries are required to obtain an Australian Financial Services License (AFSL) from ASIC. While the concept of providing financial services or offering financial advice is defined very broadly in the legislation, a license is issued for specific itemized activities and financial products. A person wishing to operate an exchange is required to obtain an Australian Market License (AML). The concept of what constitutes an exchange (or financial market) is also broadly defined. Operation of a clearing and/or settlement facility requires the appropriate license (CSFL).

23. **ASIC has only recently been given the power to draft legally enforceable market integrity rules for licensed markets and their participants.** The market integrity rules require ministerial consent. Generally the Minister proposes regulations under the Corporations Act, which are made by the Governor-General. ASIC implements legislation, regulations and the market integrity rules. ASIC can and does issue Regulatory Guides that set out how it interprets the legislation and regulations that it administers.

24. **ASIC also has the statutory power to grant relief to a person or a class of persons from certain provisions of the CA.** The power is broad. ASIC can exempt a person

or a class of persons from provisions of the CA, or declare that a provision of the CA applies as if a specified provision was omitted, modified or varied. All class order relief, with a Regulatory Impact Statement where required, must be tabled in each House of Parliament and can be disallowed by negative resolution. All class order relief is required to be registered and published on an electronic register maintained by the Attorney-General's Department. Most, but not all individual relief is required by the CA to be published by ASIC. ASIC also publishes a quarterly and anonymous compendium setting out the main themes of recent relief granted. References to individual relief granted would be included in this compendium if they contributed to a theme for a particular report.

VI. MARKET STRUCTURE

A. Market Intermediaries

25. **As at April 2012 there were 137 Market Participants in Australia.** All Market Participants are members of a licensed financial market (e.g., ASX, ASX 24 and Chi-X). ASIC has authorized 2,991 AFSL holders to access the market through a Market Participant, although not all of them in fact do so. It estimates that approximately 700 of these AFSL holders, Indirect Market Participants, currently actively provide services similar to Market Participants under their licenses.

26. **The top 20 Market Participants' market share at ASX amounted to approximately 90 percent in 2011.** Trading on ASX is dominated by Australian subsidiaries of global investment banks. All top 20 Market Participants are regulated by ASIC rather than APRA. For the majority of them (those that are also Clearing Participants), it is however ASX Clear that sets and monitors their capital requirements under the supervision of ASIC.

27. **3,345 AFSL holders are authorized to act as investment advisors and provide personal advice.** Some of these advisors are individuals rather than firms. ASIC estimates that 2,055 of these AFSL holders are permitted to deal on behalf of clients, have custody of assets, or manage client accounts.

B. Collective Investment Schemes

28. **The amount of funds under management in Australian CIS is relatively small, whereas the funds managed by superannuation funds are at a high level.** A minimum investment in superannuation funds is compulsory, and additional investments are subject to tax benefits up to a yearly limit. The definition of a CIS (called Managed Investment Scheme) is broad. At the end of 2011, funds under management in Retail MIS¹ were:

¹This table does not include information on investments in Wholesale MIS, see Principle 24 for further details.

Table 3: Funds Under Management in Retail MIS at December 31, 2011

Type of fund	A\$ billion
Listed property trusts	127.4
Unlisted property trusts	3.6
Exchange Traded Funds	4.7
Other listed equity trusts	29.5
Money Market Trusts	23.7
Unlisted equity trusts	54.4
Unlisted mortgage trusts	3.8
Unlisted other trusts	16.2
Total	263.3

Source: ASIC

C. Markets

29. **The overwhelmingly dominant exchange market group in Australia is the ASX Group.** It has approximately 98 percent of the total volume of on-exchange trading in equities and derivatives. ASX Group was created by the merger of the Australian Stock Exchange and the Sydney Futures Exchange in July 2006 and is today one of the world's top 10 listed exchange groups measured by market capitalization. ASX Group functions as a market operator and clearing house. It also oversees compliance with its Operating Rules and promotes standards of corporate governance among Australia's listed companies. Until late 2011 it had no significant competition in Australia. The following figures relate to the ASX markets only. All data is for (year end) 2011 unless otherwise mentioned.

- There were 1,983 domestic listed equity issuers and 96 foreign listed equity issuers. The total number of issuers, including listed issuers of debt securities, was 2,222.
- Domestic market capitalization was USD 1,187 billion. This is equivalent to 82.2 percent of Australia's GDP.
- Market capitalization of the top 10 companies totals A\$527 billion. This equals 37.1 percent of GDP.
- Total cash market traded value was USD 1.3 trillion.
- Average daily turnover was USD 5.4 billion.

- The proportion of market turnover accounted for by the two most actively traded companies (BHP Billiton Ltd and Rio Tinto Ltd) was 15.8 percent.
- The number of new companies listed was 133.
- Share ownership by Australians (direct and indirect) rose from 41 percent in 2008 to 43 percent in 2010.
- Foreign sourced investment activity in the shares of Australian companies was estimated to be in excess of 40 percent of the market.

30. **Derivatives are traded on-exchange and over-the-counter (OTC).** Instruments traded on ASX 24 are equity and index options, index futures, interest rate futures and options, grain futures and options, wool futures and options, and futures and options over a range of energy and environmental products. Instruments traded OTC include swaps, forward rate agreements, interest rate options, credit derivatives, and currency options.

31. **Corporate bond issuance and trading is limited although in principle there is scope for expansion.** The government issues little debt anywhere along the yield curve, and crowding out of corporate issuers is therefore not a problem. Credit conditions are tightening and companies could therefore be expected to have more interest in issuing bonds. Banks are significant users of the market issuing residential mortgage backed securities (RMBS), but the residential housing market has slowed which may provide opportunities for other issuers. One often-quoted reason for the low volumes is said to be Australians' historic preference for equity over fixed income investments, supported by tax advantages on dividend payments (although the process of retirement of the so-called "baby boomer" post war generation is said to be slowly rebalancing this bias).

32. **In practice ASX lists only 3 corporate bonds, 14 floating rate notes, 15 convertible notes and 24 hybrid securities.** On-exchange traded volumes are not available. Volume in OTC trading of non-government debt securities in 2011 was approximately A\$908 billion (versus government bond trading of A\$1,483 billion and on-exchange equity trading of A\$2.02 trillion).

33. **Exchange Traded Funds (ETF) are slowly growing in importance.** The market currently stands at around A\$5 billion.

ASX offers a trading facility for an array of financial products from simple to exotic or complex. There is a significant market in (equity) warrants although the volumes have declined sharply from a peak of A\$11.2 billion in 2008 to A\$2.9 billion in 2011. ASX also trades an assortment of retail oriented products under the generic title of Contracts for Difference (CFD). These include products where the underlying may be an equity index, equity, commodity or currency. Many managed investment schemes are also quoted on ASX. Overall volumes by instrument type over the last five years are set out below.

Table 4: Trading Volumes by Instrument Type on ASX from 2006-07 to 2010-11

A billion (turnover)	2006-07	2007-08	2008-09	2009-10	2010-11	% change since 2006
Over-the-counter (OTC)						
Government Debt Securities	772	716	792	928	1,483	92.0%
Non-Government Debt Securities	605	637	494	675	908	50.0%
Negotiable & Transferable Instruments	4,665	5,871	5,543	4,112	3,676	-21.2%
Repurchase Agreements	4,415	3,885	5,147	5,418	7,364	66.8%
Swaps	4,962	6,099	5,725	5,923	6,809	37.2%
Overnight Index Swaps	2,660	1,846	1,031	3,000	7,425	179.1%
Forward Rate Agreements	4,241	5,833	5,424	4,519	5,857	38.1%
Interest Rate Options	361	425	285	379	370	2.4%
Credit Derivatives	135	255	247	247	317	133.9%
Foreign Exchange	46,690	45,837	44,303	41,436	44,569	-4.5%
Currency Options	1,110	745	834	706	730	-34.2%
Total OTC	70,617	72,149	69,825	67,343	79,507	12.6%
Exchange Traded						
Equities	1,816	2,199	1,503	1,864	2,020	11.2%
Futures	38,259	41,496	27,192	34,338	47,702	24.7%
Total Exchange Traded	40,075	43,695	28,695	36,202	49,722	24.1%
ALL FINANCIAL MARKETS	110,692	115,844	98,519	103,544	129,229	16.7%

Source: Australian Financial Markets Association report 2011.

Competition in Trading Venues

34. **In 2010, the Australian Government announced support for competition between markets for trading in listed shares in Australia.** There had been a number of steps to allow for the announcement of support for competition, including the earlier announcement of the transfer of market and participant supervision from ASX to ASIC in 2009. Chi-X Australia was the first (and so far only) competing trading venue to successfully complete its license application. Chi-X Australia began operating in November 2011. It operates a trading platform in the 200 shares that comprise the S&P/ASX 200, ASX quoted ETFs and approximately 12 shares outside the S&P/ASX 200 selected on the basis of demand from participants.

35. **In contrast, to date there has been no overseas exchange merger that has been determined to be in the national interest.** In April 2011, the Deputy Prime Minister and Treasurer made an order under the Foreign Acquisitions and Takeovers Act 1975 prohibiting

the acquisition of ASX by Singapore Exchange Limited (SGX). In his decision he referred to advice from ASIC and the RBA that not having full regulatory sovereignty over the ASX-SGX holding company would present material risks and supervisory issues impacting on the effective regulation of the ASX's operations, particularly its clearing and settlement functions. The Government is currently consulting on the CFR proposals to make legislative change to address these concerns.

36. **ASIC's role has changed as part of the response to opening the market to competition.** Following on from its decision to open the Australian securities market to competition in the provision of exchange services the government recognized the need to introduce new rules governing the operation of exchanges and the conduct of participants dealing on the exchanges for their own account and for the account of clients. There were several elements to the situation.

37. **Firstly, the ASX was responsible for monitoring trading on its platform.** This covered indications of manipulative or other abusive trading practices, insider dealing and member regulation. The imminent opening of Chi-X, which was to provide a competing platform for trading the ASX's top 200 stocks, made this situation untenable. The solution decided upon was to transfer the powers and responsibilities for market surveillance to ASIC and to resource it sufficiently to enable it to install and operate the technology with which to surveil both markets in real time. This was done in August 2010. The second issue to resolve was securing the interconnectivity of Chi-X and ASX so as to enable the creation of a consolidated (national) best bid and offer price (NBBO) for the purposes of enabling participants to obtain best execution for their client orders and to require market participants to link to both exchanges.

38. **The transfer of market and participant supervision to ASIC was accompanied by ASIC introducing seven sets of Market Integrity Rules (MIR).** There is one set for each of the domestic markets that ASIC supervises and one set of Competition MIRs for the two markets (ASX and Chi-X) on which the same products are (competitively) traded. The first set of rules applies to market operators and market participants, and largely replicates the operating rules that were in the operators' trading rule books prior to the transfer, regulating conduct in relation to secondary trading. The Competition MIRs apply to market operators and market participants where the same product is traded on more than one market (ASX and Chi-X) and cover topics such as best execution and pre- and post-trade transparency in a multi-market environment. Their main purpose is to ensure that the same conduct in relation to the same equity market products is treated in the same manner on both exchanges. They also provide best practice standards for data consolidators.

39. **In terms of the overall regulatory architecture the key element of this process was that ASIC, for the first time, was empowered to write rules directly applicable to license holders.** This was achieved by an amendment to the CA. Ministerial approval for the rules is still necessary (except in an emergency) and the rules have to be laid before

Parliament and are subject to negative resolution. Furthermore, it was decided that the cost to ASIC of installing and operating the technology necessary to properly survey the markets should not fall on the taxpayer but should be borne directly by the industry on a cost recovery basis.

D. Preconditions for Effective Securities Regulation

The Legal System

40. **The Commonwealth of Australia has a federal system of government which consists of the Commonwealth Government, six State Governments and two Territory Governments.** The Australian Constitution (1901) establishes the Federal government and sets out the basis for relations between the Commonwealth and the States. It also provides the system of separation of powers, by providing for the Parliament, the Executive Government, and the Judiciary. The Constitution gives the legislative power to Parliament. Proposed legislation must be passed by both Houses of Parliament to become law. The Houses are elected by the Australian people and have equal powers, with minor exceptions.

41. **The nominal head of state is the Queen's representative in Australia, the Governor-General, who acts on the advice of the Executive Government.** The Executive Government administers the law and carries out the business of government through such bodies as government departments, statutory authorities and the defense forces. Only Parliament can pass Acts to create statute law, but these Acts often confer on the Executive the power to make regulations, rules and by-laws in relation to matters relevant to the particular Acts.

42. **Australia is subject to the rule of law.** The essence of the rule is that all authority is subject to, and constrained by, the law. The rule of law also means that each citizen is equal before the law; that laws must be predictable and known to all; and that laws must be fair and apply equally to the government as well as to those it governs. This includes the openness of courts, judicial independence from government and the presumption of innocence. English common law and equitable principles are the foundation of Australian laws.

43. **The Australian court system has two arms: Federal and State/Territory.** The constitution provides that the judicial powers of the Commonwealth are vested in the High Court of Australia. High Court judges are appointed by the Governor-General in Council, after extensive consultation and upon the basis of merit. Australian State and Territory courts have original jurisdiction under all matters brought under State or Territory laws and in other matters where the jurisdiction has been conferred on the courts by the Commonwealth Parliament. Only a court may exercise the judicial power and examine the question of whether a person has contravened a law of Parliament.

The Insolvency Regime

44. **The Corporations Act deals with corporate insolvency.** The relevant provisions are primarily concerned with efficient procedures for the winding up of companies, the orderly realization of available assets of those companies and the equitable distribution of the proceeds to creditors, employees and shareholders. There are also provisions governing the appointment of receivers or other persons who are entitled to assume control over particular assets of the company; the reconstruction of companies; arrangements and compromises with creditors; and the voluntary winding up of solvent companies.

45. **There are three types of external administration of insolvent companies: liquidation, receivership and voluntary administration.** A company comes under external administration when its directors must relinquish direction of its affairs to a receiver, administrator, provisional liquidator or liquidator. Directors have to consider the options for external administration because they are under a legal obligation to cause an insolvent company to cease trading. If they fail to do so they may be held personally liable for the company's debts.

VII. MAIN FINDINGS

46. **Principles relating to the Regulator:** ASIC has the primary responsibility for the regulation of securities markets and entities active on them in Australia. In some areas it shares the responsibilities with APRA, the RBA and ASX. Cooperation is organized through the CFR and bilaterally, but the division of responsibilities for the prudential supervision of AFSL holders has created a complex supervisory structure. The extent of the powers of the responsible Minister remains a concern, even though they do not generally include decision-making on day-to-day technical matters. The independence and sufficiency of resources of ASIC are hampered by the flattening of its overall operating funding over the last three years and a not insignificant dependence on non-core funding. ASIC has a wide set of powers, in the use of which it is accountable. It has focused on its ability to identify systemic risks and address issues arising from products and activities falling outside the regulatory perimeter.

47. **Principles for self-regulation:** No organizations have formal SRO status in Australia and therefore none have powers formally delegated to them by ASIC. However, operators of exchanges and clearing and settlement facilities perform certain functions that could be regarded as self-regulatory. They have statutory obligations concerning the admission of participants, ongoing obligations to monitor and regulate members and the power to impose meaningful sanctions on them. They also have statutory obligations to cooperate fully with ASIC. The entities with self-regulatory functions are subject to the oversight of ASIC. They are required to observe standards of fairness and confidentiality. The recent transfer of responsibility to ASIC for monitoring secondary trading in the market and market participants has significantly reduced the self-regulatory functions of the domestic market license holders (except as regards the listing function and clearing and settlement).

48. **Principles for the enforcement of securities regulation:** ASIC's enforcement powers are generally of long standing and well understood by licensees and the public. It has no reluctance to use its powers to enforce compliance. ASIC has a well-constructed process for filtering potential cases, for determining which cases to pursue through enforcement mechanisms and which by other means, and how to employ resources in the most efficient and effective way. ASIC is an enforcement focused regulator seeking outcomes which support its regulatory objectives. Intelligence gathering and analysis appear to work well and investment in investor education is believed to make an important contribution to enabling retail investors to better protect themselves, to recognize scams and to provide ASIC with more timely information on misconduct. ASIC has a good record in prosecuting cases, and in cooperation with the Commonwealth Director of Public Prosecutions (CDPP). Its success rate, particularly in the more serious cases, is high.

49. **Principles for cooperation in regulation:** Responsibility for responding under MABRA to requests for assistance from overseas regulators has been transferred from the Attorney-General's Department to the Treasury, which has dedicated resources to making speedy decisions. ASIC lacks authority to respond under MABRA on its own volition. The growing recognition that cross-border regulatory cooperation should encompass on-going supervision as well as enforcement highlights the limitations on ASIC's legal authority to obtain information on behalf of other regulators for supervisory purposes. Until the law is satisfactorily amended, ASIC is likely to become increasingly isolated as the scope of global inter-regulatory cooperation expands through mechanisms such as supervisory colleges and memoranda of understanding focused on supervisory rather than enforcement matters. The Government is currently in the process of progressing amendments to the MABRA Act and MABRA Regulations which are intended to provide ASIC the capacity to respond to requests for information from individual foreign regulators for supervisory purposes. However, the issue of sharing supervisory information in international supervisory colleges remains currently unresolved.

50. **Principles for issuers:** ASIC has issued a series of Regulatory Guides on prospectus disclosure to assist issuers and their advisors to produce disclosure documents that help retail investors better assess the offer. Australian listed companies and some others operate under a legislative requirement for immediate and continuous disclosure to the public of significant information, with the object of securing a fully informed market. ASIC has a long standing policy of bringing cases to court against companies, company directors and their professional advisors for breach of their obligations under the continuous disclosure regime. Recent court decisions in several high profile cases have found in favor of ASIC, usually on appeal. ASIC is the regulator of corporate conduct, takeovers and other control transactions. The Takeovers Panel is a peer-based dispute resolution mechanism with the courts as the final backstop. Australia has adopted a comprehensive body of accounting standards, which follow the International Financial Reporting Standards (IFRS). The annual accounts of a listed company must be audited, with the half-yearly reports subject to either review or audit.

51. **Principles for auditors, credit rating agencies, and other information service providers:** Australia has adopted auditing standards based on the International Standards on Auditing (ISA). The cooperation between the relevant public interest bodies, ASIC (which supervises auditors and enforces standards), the Financial Reporting Council (FRC), the Auditing and Assurance Standards Board (AUASB), the Companies Auditors and Liquidators Disciplinary Board (CALDB), and the auditors' professional bodies appears effective. The regime for licensing and supervising credit rating agencies (CRA) is fully operational. CRAs are required to meet all the requirements set out in the IOSCO Code of Conduct Fundamentals for CRAs. Research report providers are regulated as AFSL holders, which ensure that they are subject to comprehensive requirements to manage any conflicts of interest.

52. **Principles for collective investment schemes:** All CIS operators are required to be authorized and are subject to conduct of business, capital and organizational requirements. Retail CIS need to be registered with ASIC and comply with requirements set out in the CA and ASIC RGs, whereas there are no regulatory requirements on Wholesale CIS. ASIC's proactive supervision is currently limited. The assets of a CIS have to be adequately segregated, but self-custody or related party custody is allowed subject to certain additional requirements that do not appear to be sufficiently stringent. Initial, ongoing and periodic disclosure requirements apply, but there are no standardized formats for all disclosures. There are requirements on valuation and pricing of CIS units. The regulatory framework for CIS applies to hedge funds and their operators, but ASIC lacks certain powers needed for effective oversight and cooperation.

53. **Principles for market intermediaries:** Market intermediaries need to hold an AFSL specifying the services and products they are authorized to provide. The licensing process appears thorough; however the assessment of the applicant does not extend to its controllers. Capital requirements are largely not risk-based. Intermediaries are subject to a suite of prudential, organizational and conduct of business requirements, whereas internal controls are addressed only indirectly. There is no general statutory requirement to act in the best interest of clients; however, there are specific requirements for certain market intermediaries relating to best interest type duties. Even though a significant amount of intermediaries may still remain uninspected for extended periods of time, ASIC has expanded its supervisory reach during the past few years. ASIC, jointly with other CFR members, has plans in place to deal with a failure of a systemically important financial institution. ASIC's own plans address the possible failure of non-systemic entities.

54. **Principles for secondary markets:** The power to grant licenses to exchanges and clearing and settlement facilities and to approve their operating rules resides with the Minister. ASIC processes license applications and all rule changes prior to submitting them to the Minister with a recommendation. ASIC's oversight of the exchanges is effective. The transfer of responsibility for surveillance of secondary trading activity to ASIC in August 2010 has somewhat reduced the role of the exchanges in ensuring that their markets are fair,

orderly and transparent. Exchanges (market operators) have however retained rules and procedures concerning, among others, participant admission, order types and trading arrangements. They have also retained responsibility for listing and monitoring compliance by listed entities with their continuous and periodic disclosure obligations. The primary regulator of the clearing and settlement facilities is the central bank (RBA). The principal tool used by the RBA is its continuous assessment of a CSFL holder's performance against the Financial Stability Standards (FSS) it has developed. Prudential regulation of off-exchange business, where AFSL holders are not regulated by APRA or as Clearing or Market Participants, is a source of weakness.

Table 5. Summary Implementation of the IOSCO Principles—Detailed Assessments

Principle	Grade	Findings
Principle 1. The responsibilities of the Regulator should be clear and objectively stated.	FI	The responsibilities of ASIC are clearly set out in the CA and ASIC Act. It has a wide power to provide relief and exemptions under the CA, which it exercises in a transparent manner within the current constraints of the law. The sharing of supervisory responsibilities for market intermediaries between ASIC, APRA and operators of the ASX Group's clearing facilities has created a complex supervisory structure. The Minister retains certain responsibilities for the AML and CSFL holders, and the RBA is involved in setting standards for clearing and settlement facilities. Cooperation arrangements between the authorities have been established.
Principle 2. The Regulator should be operationally independent and accountable in the exercise of its functions and powers.	PI	Certain features of the CA and ASIC Act have the potential of impacting on the independence of ASIC. These relate in particular to the powers of the responsible Minister to give directions to ASIC, express his expectations, and decide on matters relating to AML and CSFL holders. There is no evidence of the interference of the Minister in day-to-day decision making of ASIC. ASIC's operational independence is constrained by increased dependence on non-core funding. Sufficient accountability measures are in place, and the decisions of ASIC are subject to the requirement to provide reasons as well as an appropriate review mechanism.
Principle 3. The Regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.	PI	ASIC has a wide set of powers that enable it to discharge its duties under the CA and the ASIC Act. Its funding level, although sufficient to undertake its current tasks, does not enable it to reach a level of proactive supervision necessary in the increasingly complex markets. ASIC is also dependent on non-core funding allocated to specific regulatory tasks. It has been able to retain and attract a mix of staff with varying

Principle	Grade	Findings
		backgrounds. Its governance practices and policies are well established and it is very active in investor education.
Principle 4. The Regulator should adopt clear and consistent regulatory processes.	FI	ASIC has a well developed consultation process that is subject to a requirement to conduct a regulatory impact analysis. Its website includes extensive information on its policy making procedures and the guidance and decisions it has issued. It is required to apply procedural fairness in its decision making, including a right to a hearing, where appropriate.
Principle 5. The staff of the Regulator should observe the highest professional standards, including appropriate standards of confidentiality.	FI	ASIC Commissioners and staff are subject to a code of conduct pertaining to avoidance of conflicts of interest. Relevant members of staff are subject to trading restrictions. Strict confidentiality and data protection requirements apply to staff, with sanctions applied on non-compliance.
Principle 6. The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.	FI	ASIC has established an internal Emerging Risks Committee (ERC) tasked to deepen its understanding on emerging risks in securities markets, including any systemic risks. ASIC also works with other domestic regulators, primarily through the Council of Financial Regulators, to decide on appropriate regulatory responses to risks facing the Australian financial system.
Principle 7. The Regulator should have or contribute to a process to review the perimeter of regulation regularly.	FI	The ERC is the main vehicle through which ASIC identifies and assesses the continued appropriateness of its regulatory framework in light of financial innovation. The ERC uses various mechanisms to identify any emerging risks, including analysis of market trends and surveillance observations of ASIC stakeholder teams. The specific regulatory actions taken on the basis of the ERC work are still limited.
Principle 8. The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.	FI	The regulatory framework requires all regulated entities to have in place appropriate processes to identify and manage actual and potential conflicts of interest. ASIC monitors compliance with these requirements through its supervisory activities. It has also taken measures to address misaligned incentives among issuers and regulated entities.
Principle 9. Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.	FI	No organizations have formal SRO status in Australia and none have powers formally delegated to them by ASIC. Exchanges and clearing and settlement facilities have statutory obligations to have membership criteria, to regulate the conduct of their members and to impose sanctions for rule breaches. They are subject to intensive oversight by ASIC. As a consequence of ASIC's assumption of

Principle	Grade	Findings
		responsibility for market supervision in 2010, the exchanges are now responsible for enforcing a smaller suite of operating rules.
Principle 10. The Regulator should have comprehensive inspection, investigation and surveillance powers.	FI	ASIC has comprehensive powers over regulated and other persons to obtain information. This is reinforced by dissuasive sanctions for refusal to comply and supported by extensive record-keeping requirements on the corporate and business sectors.
Principle 11. The Regulator should have comprehensive enforcement powers.	FI	ASIC's enforcement powers are long standing and well understood by licensees and the public. It has no reluctance to use its powers to enforce compliance. ASIC has a well-constructed process for filtering potential cases, for determining which cases to pursue through enforcement mechanism and which by other means, and how to employ resources in the most efficient and effective way.
Principle 12. The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.	BI	ASIC is an enforcement focused regulator and devotes considerable time and resources to determining the outcomes it seeks and prioritizing cases to achieve those outcomes. In recent years its successful prosecution of several high profile cases has increased its credibility as the enforcer of securities and company law. While enforcement by ASIC is effective and credible, the performance of certain supervisory functions has relative weaknesses in terms of proactive as distinct from reactive supervision.
Principle 13. The Regulator should have authority to share both public and non-public information with domestic and foreign counterparts.	BI	The global financial crisis has highlighted the need for regulators to move beyond sharing information on enforcement matters to supervisory matters, particularly for SIFIs and other complex global groups. Legal limitations on ASIC's power to share information for supervisory purposes bilaterally and in colleges of supervisors risk increasingly isolating it from international supervisory cooperation. The Government is progressing amendments to the relevant law and regulations expected to be in place by late 2012 that are intended to remove at least some of these limitations and bolster ASIC's capacity for international regulatory cooperation on supervisory matters. However, the issue of sharing supervisory information in international supervisory colleges remains currently unresolved.

Principle	Grade	Findings
Principle 14. Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.	FI	ASIC's work in this area is in the forefront of regulators striving to improve information sharing (subject to the limits on its powers as described in Principle 13). Arrangements with Hong Kong and New Zealand to encourage cross-border offerings of securities and CIS are particularly innovative and contribute to enhancing global trade in financial services subject to appropriate regulatory oversight.
Principle 15. The regulatory system should allow for assistance to be provided to foreign Regulators who need to make inquiries in the discharge of their functions and exercise of their powers.	BI	ASIC has a demonstrably good record in providing assistance to foreign regulators, subject only to the limitations identified in Principle 13.
Principle 16. There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.	FI	The Regulatory Guides that ASIC has recently released on the disclosure regime for public offerings have elevated the regime to the standard required. ASIC's long standing policy of bringing cases to court against companies, company directors and their professional advisors for breach of their obligations has recently shown a significantly improved success rate. These cases have sent clear signals to directors as to the full scope of their legal responsibilities. In so doing they have enhanced ASIC's ability to enforce the corporate disclosure regime.
Principle 17. Holders of securities in a company should be treated in a fair and equitable manner.	FI	The separation of powers where ASIC regulates the conduct of takeovers and other means of securing or changing control, while the Takeovers Panel operates as a peer-based dispute resolution mechanism, appears to work effectively. It has widespread acceptance among corporations, their professional advisors and the public. ASIC is sensitive to the need to be alert for new financing techniques with the potential of reducing the accuracy and timeliness of shareholder information.
Principle 18. Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.	FI	The standard setting process is of a high quality with the appropriate mix of development by the AASB and other stakeholders in a fully transparent manner. It ensures that Australian standards remain fully consistent with IFRS. ASIC's regulatory role in securing compliance with accounting standards appears to work well in detecting errors and mandating corrections in financial reports. It is supported by dissuasive sanctions for dishonest contraventions.

Principle	Grade	Findings
Principle 19. Auditors should be subject to adequate levels of oversight.	FI	ASIC has significant powers of investigation, inspection and information gathering in relation to auditors and audit practices, which it exercises in a coherent and consistent manner. Its interactions with the Government funded Companies Auditors and Liquidators Disciplinary Board (CALDB) appear effective. ASIC is alert to the global phenomenon of pressure on audit fees and the risks that can arise to the quality of audit due to the competitive nature of the audit profession.
Principle 20. Auditors should be independent of the issuing entity that they audit.	FI	Constraints on auditors and audit companies carrying out non-audit work for the same client are extensive, well defined and consistent with international norms.
Principle 21. Audit standards should be of a high and internationally acceptable quality.	FI	As with accounting standards, Australia has adopted auditing standards based on the International Standards on Auditing (ISA). One role of the Government appointed standard setter, the AUASB, is to ensure that Australian auditing standards are maintained at that level.
Principle 22. Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.	FI	ASIC has acted in a timely and comprehensive manner to implement the IOSCO Code and to impose a fully compliant supervisory program on CRAs. It may prove over time that the attempt to prevent retail investors from accessing CRA ratings because five of the six CRAs have opted for “wholesale only” licenses will be ineffective in practice.
Principle 23. Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.	FI	Research report providers are required to hold an AFSL and are therefore subject to all the regulatory requirements applicable to AFSL holders, including those on conflicts of interest. ASIC has issued specific guidance to research report providers. With regards to other providers of evaluative services, ASIC has given guidance to experts emphasizing their need to act independently. It has also identified other possible providers of evaluative services that might warrant regulation.
Principle 24. The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.	PI	All CIS operators are required to be authorized as AFSL holders and are subject to a full range of conduct of business and organizational requirements (see Principle 29), with REs of Retail CIS required to fulfill certain additional criteria. Retail CIS need to be registered with ASIC and comply with requirements set out in the CA and ASIC RGs, whereas Wholesale CIS are not subject to any regulatory requirements. ASIC’s supervision is focused on reactive and desk-based activities rather than fully fledged on-site inspections.

Principle	Grade	Findings
Principle 25. The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.	BI	A CIS is broadly defined in the CA, but in practice most take the legal form of investment trusts. The requirement to lodge the constitution of a Retail CIS with ASIC ensures that the form and structure requirements are complied with. The assets of a CIS have to be adequately segregated, but it is possible for them to be held in custody by the RE itself or by a related entity. In those cases, safeguards are not strong enough.
Principle 26. Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.	BI	A potential investor in a Retail CIS needs to be provided with a PDS. From June 2012 onwards the PDS for a Simple CIS is required to comply with a standard eight page format. The PDS used for other types of CIS and other disclosure documents are not required to be in a standard format. Wholesale CIS are not subject to disclosure requirements. ASIC has a possibility to intervene in case of non-compliance with regulatory requirements when the PDS is filed with ASIC. There are rules and guidance on periodic reporting and advertizing, and the investment policy of a Retail CIS and information on asset valuation need to be disclosed.
Principle 27. Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.	FI	The constitution of a Retail CIS has to set out the rules for valuation of scheme assets. ASIC and APRA have issued further guidance on valuation. Independent auditors are required to assess compliance of the valuations with accounting standards. The constitution of a Retail CIS needs to address the subscription and redemption rights of unit holders, including pricing. Treatment of pricing errors and possibility of suspending redemptions are addressed in the regulatory framework.
Principle 28. Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.	BI	Retail hedge funds and their REs are subject to the same requirements as other Retail CIS and their operators. The same applies to disclosure requirements. ASIC has the power to collect information from hedge fund operators, subject to existing restrictions in sharing that information with foreign regulators (see Principles 13 and 15). Hedge fund operators have recently become subject to increased ASIC supervision.

Principle	Grade	Findings
Principle 29. Regulation should provide for minimum entry standards for market intermediaries.	BI	Market intermediaries need to hold an AFSL specifying the services and products they are authorized to provide. ASIC applies a comprehensive desk-based licensing process that can be varied depending on the applicant and the services and products it seeks authorization for. ASIC has a variety of powers relating to the licensing decisions. Controllers, other significant shareholders and those with significant voting power are not assessed as part of the licensing process. Authorization requirement covers all types of investment advisers.
Principle 30. There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.	PI	Initial and ongoing capital requirements apply for all AFSL holders. With the exception of bodies regulated by APRA and direct members of financial markets and clearing facilities, they are not adjusted for risk and there is no periodic reporting to ASIC other than annually. Additional reporting requirements apply in case of deteriorating financial conditions. The annual reports of AFSL holders need to be audited by independent auditors. The capital requirements do not take into account risks arising from unlicensed affiliates. ASIC is currently undertaking a progressive review of the financial resources requirements applying to all AFSL holders; the compliance of the envisaged new requirements with Principle 30 was not assessed
Principle 31. Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.	BI	AFSL holders are required to maintain appropriate risk management and compliance systems. There is no general statutory requirement to act in the best interest of clients; however, there are specific requirements for certain market intermediaries relating to best interest type duties. There is no specific regulatory requirement to maintain sufficient internal controls. Client asset protection rules, know-your customer-rules, record-keeping requirements and key conduct of business requirements apply to AFSL holders. Direct market participants are subject to a risk-based supervisory program with a three year cycle, and ASIC is in the process of extending its proactive supervision to the most important indirect market participants, and to a lesser extent, investment advisors.

Principle	Grade	Findings
Principle 32. There should be procedures for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.	FI	ASIC, jointly with other CFR members, has plans in place to deal with a failure of a systemically important financial institution. ASIC's own plans address the possible failure of non-systemic entities. ASIC has various powers to deal with an intermediary failure, including power to immediately cancel a license in case of insolvency. Market operators are required to maintain a guarantee fund applicable to their participants. Other AFSL holders are subject to a requirement to hold a PII, whereas there is no investor compensation scheme in Australia.
Principle 33. The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.	FI	The CA definition of a financial market is very broad. It however fails to capture some trading systems which, in terms of the policy rationale for defining a financial market, should be regulated. The regulation of market infrastructure providers may not be sufficiently efficient, particularly in light of the increased pace of innovation and change in trading practices and the growing inter-connectivity of Australian markets.
Principle 34. There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.	FI	The current position, where exchange competition has existed only since November 2011, is viewed by ASIC and others as a transitional phase which has not yet been completed. As a result, there appears to be a number of areas where not all those involved in the market understand yet whether the responsibility for monitoring and enforcing particular rules falls to ASIC or the relevant exchange. This can lead to uncertainty among licensees on the rulebook they should look to for compliance.
Principle 35. Regulation should promote transparency of trading.	FI	The regulatory framework includes appropriate requirements for timely pre- and post-trade transparency, subject to standard derogations. ASIC's analytical work on dark pools, dark liquidity and high frequency trading is well regarded by the industry. While opinions differ as to ASIC's conclusions to date, there appears to be a consistent view that the work is based on a sufficient amount of accurate data and has been properly and impartially carried out having regard to ASICs regulatory priorities to secure fair, orderly and transparent markets.

Principle	Grade	Findings
Principle 36. Regulation should be designed to detect and deter manipulation and other unfair trading practices.	FI	Australia has a comprehensive legal framework to deal with market manipulation, insider dealing and other types of market abuse supported by dissuasive sanctions. ASIC has employed a range of systems and human resources to monitor markets and detect possible offences. The working relationship between ASIC and the office of the Commonwealth Director of Public Prosecutions (CDPP) appears to be effective and efficient. The CDPP and the judiciary appear fully cognisant of the need to pursue white-collar crime as vigorously as other forms of crime.
Principle 37. Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.	PI	There are no rules governing the proper management of large exposures, default risk and market disruption that arise from bilateral transactions involving AFSL holders that are not supervised by APRA and are also not supervised by ASX as Clearing Participants or by ASIC as Market Participants. Some questions have been raised about the legal provision concerning the powers of the clearing facility operator to transfer client positions from a failing firm to a viable one.
Principle 38. Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.	NA	Not assessed.
Fully Implemented (FI), Broadly Implemented (BI), Partly Implemented (PI), Not Implemented (NI), Not Applicable (NA)		

Table 6. Recommended Action Plan to Improve Implementation of the IOSCO Principles

Principle	Recommended Action
Principle 1	<ol style="list-style-type: none"> 1) ASIC, APRA and ASX are encouraged to continue to further develop their cooperation mechanisms to ensure appropriate supervision of jointly supervised entities. 2) Going forward, the Government and the supervisory authorities should assess whether the current regulatory set-up continues to best ensure the protection of investors and the reduction of systemic risk. 3) The Government and ASIC should consider the continued appropriateness of the legal prohibitions to publish certain individual relief in order to provide maximum transparency possible.
Principle 2	<ol style="list-style-type: none"> 1) The Government should consider the continued appropriateness of the extent of the powers assigned to the Minister to ensure sufficient independence of ASIC. Particular attention should be paid to the role of the Minister in relation to licensed markets and clearing and settlement facilities. 2) The Government should explore ways to secure the stability of ASIC's core funding.
Principle 3	<ol style="list-style-type: none"> 1) The Government should ensure that ASIC's core funding will be sufficient to meet the future regulatory and supervisory challenges, also in light of the global regulatory commitments. 2) ASIC should aim at allocating more resources to reach sufficient levels of proactive supervision of all types of entities under its supervision.
Principles 6 and 7	<p>ASIC is encouraged to continue to develop the ERC and to ensure maintaining its focus on emerging and systemic risks. It could consider using it as a vehicle to identify risks from existing regulatory gaps (see also recommendations for the Principles for CIS).</p>
Principle 9	<p>In light of the reduced responsibilities of exchanges for market monitoring, ASIC should continue to refine its oversight role to focus on those areas where the functions undertaken by the exchanges are key to effective implementation of ASIC's objectives.</p>
Principle 12	<p>ASIC should reinforce its initiative to develop proactive supervision as regards MIS, REs and market intermediaries including investment advisors.</p>

Principle	Recommended Action
Principles 13 and 15	The Government should complete the legislative process to expand ASIC's powers to share supervisory information with foreign regulators on the basis of participation in supervisory colleges as well as bilaterally.
Principle 24	<ol style="list-style-type: none"> 1) ASIC should allocate more resources to the proactive supervision of REs and MIS. 2) ASIC and APRA should cooperate to ensure that all REs, independent of their primary prudential regulator, are subject to similar supervision of risks arising from their role as fund manager. 3) ASIC should gain access to sufficient information on the Wholesale Funds sector to ensure it is subject to appropriate regulation that takes into account the risks to investor protection and financial stability.
Principle 25	The Government and ASIC should increase safeguards to ensure sufficient client asset protection in case of self-custody and related party custody by, for example, requiring the custodian to hold a higher amount of capital, by providing additional guidance on operational safeguards and by requiring independent verification on the robustness of the custodial arrangements.
Principle 26	<ol style="list-style-type: none"> 1) The Government and ASIC should seek further harmonization of the content and format of all disclosure documents to assist investors in comparing various investment opportunities. 2) The Government and ASIC should consider the continued appropriateness of the lack of disclosure requirements for Wholesale Funds.
Principle 28	Refer to recommendations for Principles 13, 15, 24 (1 st and 3 rd item) and 26.
Principle 29	The Government should extend the good fame and character test to controllers, other significant shareholders, holders of a significant amount of voting power and those that are otherwise in a position to materially influence a license applicant.
Principle 30	ASIC should introduce risk-based capital requirements and periodic capital adequacy reporting for all AFSL holders. This would provide an opportunity to seek ways to simplify and harmonize the current complex regime.

Principle	Recommended Action
Principle 31	<ol style="list-style-type: none"> 1) The Government and ASIC should introduce appropriate requirements for internal controls for all AFSL holders, and require adequate periodic evaluation of these controls and risk management arrangements. 2) The Government should ensure that a requirement for AFSL holders to act in the best interest of clients applies to all market intermediaries. 3) ASIC should extend its proactive supervision program to sufficiently cover all types of market intermediaries.
Principle 32	The Government should consider the additional investor protection benefits that an investor compensation scheme would bring.
Principle 33	<ol style="list-style-type: none"> 1) The Government may wish to consider whether, in the light of technology driven changes to securities markets globally, and the recent adoption in Australia of a competitive market for the provision of trading platforms, the current two stage process of licensing and rule approval for exchanges and clearing and settlement facilities should be simplified and the powers transferred to ASIC. 2) Consistent with the above, the Government may wish to consider amending the definition of a financial market in the CA to provide a better tool with which to regulate the evolving structure and diversity of financial markets in Australia.
Principle 34	ASIC should give priority to eliminating any remaining overlaps and ambiguities emerging from the transfer of responsibility to ASIC for market surveillance and the supervision of non-clearing ASX members.
Principle 37	<ol style="list-style-type: none"> 1) In addition to ASX Clearing Participants, ASIC should extend the large exposure requirements to all AFSL holders whose license conditions potentially enable them to acquire large exposures relative to their capital base to match global best practice. The Government and ASIC should analyze any issues concerning the powers of ASIC or the clearing facility operator to transfer client positions from a failing firm to a viable one and seek appropriate remedies, if necessary.

VIII. AUTHORITIES' RESPONSE TO THE ASSESSMENT²

A. Introduction

55. **The Australian authorities welcome the comprehensive assessment of Australian securities regulation as part of the IMF's Financial Sector Assessment Program.** The authorities broadly consider that the assessment is tough but fair.

56. **The authorities welcome the IMF's assessment** that the Australian legal and regulatory framework reflects a high degree of compliance with the IOSCO objectives and principles of securities regulation.

57. **Australia is already taking steps to implement some of the IMF's recommendations.** The assessment underscores the importance of work already in train. The authorities will carefully consider the other recommendations, as discussed below.

58. **We also make comment below on certain other aspects of the assessment.**

Independence of the Regulator

59. **The Australian authorities do not consider that the Minister's power to direct ASIC impedes ASIC's independence in any way** (Principle 2, Recommendation 1).

60. **ASIC has complete independence in relation to the performance of its functions and exercise of its powers under the corporations legislation.** While the IOSCO principles require an additional degree of autonomy in relation to regulatory policies and funding, it is difficult to reconcile the IOSCO approach to independence with notions of ministerial accountability.

61. **The authorities do not consider that the Minister's powers impair or interfere with ASIC's ability to discharge its functions.** The Minister's power to issue a direction to ASIC with respect to policies and priorities is limited and has only been exercised once and then some 20 years ago. Although the Minister has the power to revoke a direction given by ASIC, this has never happened. If it did, the Minister's powers are circumscribed by the law. The theoretical and unlikely possibility of inappropriate intervention does not, in fact, impair ASIC's operational independence or its ability to discharge its functions.

62. **The authorities agree that there could be room to streamline the licensing process for exchanges and clearing and settlement facilities** (Principle 33, Recommendation 1) and will consider how best to respond to this recommendation.

²If no such response is provided within a reasonable time frame, the assessors should note this explicitly and provide a brief summary of the authorities' reactions at the conclusion of the discussions.

Funding of the Regulator

63. **In general, the Australian authorities note that the Government's overall approach to fiscal policy in which all public sector spending is subject to robust discipline, has served Australia well,** ensuring adequate funding for government services and agencies while producing a degree of sustained fiscal responsibility unmatched by many other OECD economies.

64. **In relation to stability of funding (Principle 2, Recommendation 2), the Australian Government has supported ASIC's regulatory role with funding increases over recent years.** Funding for ASIC has grown since the FSAP was last conducted in 2006, with total forecast operating revenue rising from \$261.3m in 2007-08 to peak at \$360.6m in 10-11 (reflecting temporary funding to assist ASIC to deal with a spike in work flowing from the financial crisis) to \$352.7m in 2012-13, and is projected to remain at roughly this level across the forward estimates. The Government will continue to ensure the stability of ASIC's funding.

65. **In relation to adequacy of funding (Principle 3, Recommendation 1), the authorities agree that it will be important to ensure that ASIC's funding continues to be sufficient to meet the regulatory and supervisory challenges it faces, in light of global regulatory commitments.**

Transparency

66. **The authorities will consider the continued appropriateness of laws prohibiting the publication of certain individual relief instruments (Principle 1, Recommendation 3).** The authorities note that ASIC publishes a quarterly report which provides an overview of circumstances in which ASIC has exercised or refused to exercise its exemption or modification powers.

Relations with other Regulators

67. **The authorities welcome the endorsement of the Council of Financial Regulators (CFR) as a forum for cooperation and collaboration between its members.**

68. **The assessment recommends that the authorities should assess whether the current regulatory set-up continues to best ensure investor protection (Principle 1, Recommendation 2).** The authorities will consider how best to respond to this recommendation.

69. **The authorities note that the division of roles among the CFR agencies is generally well understood and Australia's regulatory set-up has stood Australia in good stead through the crisis.** However, the authorities will continue to work towards furthering their cooperation mechanisms to ensure appropriate supervision of entities which are subject

to supervision by both APRA and ASIC in line with IMF recommendations (Principle 1, Recommendation 1 and Principle 24, Recommendation 2).

Systemic Risk

70. **The authorities appreciate the encouragement given to ASIC's Emerging Risks Committee and will work to ensure it continues to focus on emerging and systemic risks (Recommendation under Principles 6 and 7).**

Investor Protection

71. **The assessment recommends that the Government should consider the additional investor protection benefits that an investor compensation scheme would bring (Recommendation on Principle 32).** The Government is currently reviewing the costs and benefits of a statutory investor protection scheme. The authorities will consider how best to respond to the recommendation based on the outcome of that review.

Proactive Supervision

72. **The authorities note the IMF's comments on the need for proactive supervision of particular parts of its regulated population, subject to available funding.** ASIC has begun work on a program designed to standardize its approach to surveillance, and will take these comments into account in refining its approach to supervision (Principle 3, Recommendation 2; Recommendation on Principle 12; Principle 24, Recommendation 1 and Principle 31, Recommendation 3).

International Information Sharing and Cooperation

73. **The Australian Government is progressing amendments to the law to allow ASIC to collect information in response to requests from foreign regulators in a broader range of circumstances than at present.** The authorities will consider whether it is appropriate also to permit the collection of information for and sharing of information with supervisory colleges (Recommendation on Principles 13 and 15).

Regulation of Collective Investment Schemes

74. **The authorities agree with the recommendation that ASIC should collect data so it can continue to be confident that the wholesale sector is subject to appropriate regulation that takes into account the risks to wholesale investors and financial stability (Principle 24, Recommendation 3).**

75. **The authorities note that Australia has a tailored regulatory framework, based on the degree of protection required.** This is the rationale behind the current distinction between wholesale and retail clients under which retail collective investment schemes and their operators are subject to a significantly higher level of regulation and oversight.

76. **The authorities will nevertheless consider the continued appropriateness of the lack of disclosure requirements for wholesale funds (Principle 26, Recommendation 2).**

77. **The authorities will also consider whether further harmonization of the content and format of disclosure documents will assist investors in comparing investment options (Principle 26, Recommendation 1).** There are minimum requirements for content and format requirements for certain types of collective investment schemes. While the current requirements work well in practice, the authorities will consider where improvements can be made.

78. **The authorities will consider the IMF's suggestion that safeguards should be increased to ensure sufficient client asset protection in case of self custody and related party custody (Recommendation on Principle 25).** The Authorities note that ASIC is currently reviewing custody standards, including financial requirements, applying in relation to custody (including self custody) of property in retail collective investment schemes.

Authorization and Ongoing Obligations of AFSL Holders

79. **The assessment makes the following recommendations about authorization and ongoing obligations of AFSL holders:**

- a. The good fame and character test (applicable at the time of authorization) should be extended to controllers, other significant shareholders, holders of significant amount of voting power and those that are otherwise in a position to materially influence a license applicant (Recommendation on Principle 29);
- b. Appropriate internal control requirements for market intermediaries and periodic evaluation of such requirements should be introduced (Principle 31, Recommendation 1); and
- c. The requirement to act in the best interest of clients should apply to all market intermediaries (Principle 31, Recommendation 2).

80. **The authorities will consider the appropriateness of these recommendations for Australia, noting, in particular, the large scope of the second requirement.** In relation to the 'best interests' requirement, the authorities note that the Future of Financial Advice reforms have introduced a duty for financial advisers to:

- a. Act in the best interests of their clients (subject to a reasonable steps qualification); and
- b. Place the best interests of their clients ahead of their own when providing personal advice to retail clients.

Risk-based Capital Requirements

81. **The assessment recommends that ASIC should introduce risk-based capital requirements and periodic capital adequacy reporting for all AFSL holders (Recommendation on Principle 30).**

82. **ASIC has commenced a process to review capital requirements for all entities it licenses, in line with the IOSCO Principles.** However, the authorities consider that risk based capital requirements and periodic capital adequacy reporting are not necessarily appropriate for all AFSL holders. Some AFSL holders are very small entities that do not hold client assets or are not significant enough to warrant risk based capital requirements and periodic capital adequacy reporting.

Market Oversight

83. **The authorities welcome the positive comments about the effectiveness of ASIC's oversight of exchanges and Australia's framework for dealing with market abuse.**

84. **The assessment recommends that ASIC continue to refine its market oversight role (Recommendation on Principle 9) and give priority to eliminating any overlaps and ambiguities emerging from the transfer of market surveillance and supervision of non-ASX members (Recommendation on Principle 34).** ASIC notes these recommendations and will continue to work with industry to refine its oversight role as markets develop.

85. **The authorities will also consider the costs and benefits of amending the definition of financial market in the Corporations Act to better regulate the evolving structure and diversity of financial markets (Principle 33, Recommendation 2).**

86. **The authorities will also analyze any issues concerning the powers of ASIC of the clearing facility operator to transfer client positions from a failing firm to a viable one and seek appropriate remedies, if necessary (Principle 37, Recommendation 2).**

Large Exposures

87. **The assessment expresses concern about potential exposures arising from bilateral transactions involving AFSL holders supervised neither by APRA nor by the operator of a clearing and settlement facility.** The assessment, therefore, recommends that ASIC should extend the large exposure requirements to all AFSL holders whose license conditions enable them to acquire large exposures relative to their capital base (Principle 37, Recommendation 1).

88. **Since only a very small proportion of OTC derivative transactions are conducted by AFSL holders that are supervised neither by APRA nor by the operator of a clearing**

and settlement facility, the authorities have assessed the risk posed as small. They will, however, take the views expressed in the assessment into account.

89. **The G20 requirements for reporting OTC derivative transactions to trade repositories may assist in this regard.** The Australian government has released, for public consultation, draft legislation to implement the G20 reforms. Under the draft legislation, ASIC would be able to write rules imposing mandatory reporting obligations on persons, including AFSL holders that undertake specific OTC derivatives transactions. The mandatory reporting requirements may be relevant to this recommendation. After the first stage of implementation, it could usefully be assessed whether there are any remaining material gaps in the monitoring or regulation of large exposures.

Summary

90. **The authorities will continue to evaluate, and as appropriate, implement, the FSAP's recommendations.** The authorities look forward to continuing dialogue with the IMF to further our goal of enhancing Australia's regulatory and supervisory framework

IX. DETAILED ASSESSMENT

91. **The purpose of the assessment is primarily to ascertain whether the legal and regulatory securities markets requirements** of the country and the operations of the securities regulatory authorities in implementing and enforcing these requirements in practice meet the standards set out in the IOSCO Principles. The assessment is to be a means of identifying potential gaps, inconsistencies, weaknesses and areas where further powers and/or better implementation of the existing framework may be necessary and it is used as a basis for establishing priorities for improvements to the current regulatory scheme.

92. **The assessment of the country's observance of each individual Principle is made by assigning to it one of the following assessment categories:** fully implemented, broadly implemented, partly implemented, not implemented and not applicable. The IOSCO assessment methodology provides a set of assessment criteria to be met in respect of each Principle to achieve the designated benchmarks. The methodology recognizes that the means of implementation may vary depending on the domestic context, structure, and stage of development of the country's capital market and acknowledges that regulatory authorities may implement the Principles in many different ways.

- A Principle is considered **fully implemented** when all assessment criteria specified for that Principle are generally met without any significant deficiencies.
- A Principle is considered **broadly implemented** when the exceptions to meeting the assessment criteria specified for that Principle are limited to those specified under the broadly implemented benchmark for that Principle and do not substantially affect the overall adequacy of the regulation that the Principle is intended to address.

- A Principle is considered **partly implemented** when the assessment criteria specified under the partly implemented benchmark for that Principle are generally met without any significant deficiencies.
- A Principle is considered **not implemented** when major shortcomings (as specified in the not implemented benchmark for that Principle) are found in adhering to the assessment criteria specified for that Principle.
- A Principle is considered **not applicable** when it does not apply because of the nature of the country's securities market and relevant structural, legal and institutional considerations.

Table 7. Detailed Assessment of Implementation of the IOSCO Principles

Principles Relating to the Regulator	
Principle 1.	The responsibilities of the regulator should be clear and objectively stated.
Description	<p>Responsibilities and powers</p> <p>As described in section IV above, ASIC is the main authority responsible for the regulation of securities markets in Australia. The role of other authorities (APRA and the RBA) and the SROs (most importantly the ASX Group) is limited to certain specific areas covered by the IOSCO Principles, for which reason the assessment of this Principle focuses on ASIC. ASIC's responsibilities, powers and authority are set out in the ASIC Act. It has general responsibility for the administration of the ASIC Act and the Corporations Act 2001 (CA). In addition to the functions and powers conferred on it under the CA, its functions are defined in s11(2) and 12A of the ASIC Act.</p> <p>S2(g) of the ASIC Act requires ASIC to strive to take whatever action it can take, and is necessary, in order to enforce and give effect to the law of the Commonwealth that confers functions and powers on it. It can enforce the law through a number of administrative, civil and criminal measures described in more detail under Principles 10 and 11. When ASIC's Regulatory Guides (RGs) are issued as guidance expressing its interpretation of the law, it can also use them as the basis of its enforcement action.</p> <p>Interpretation of authority</p> <p>In addition to interpreting the law in its RGs, ASIC can modify (narrow or vary) the application of the CA and grant relief from its application if the objectives of the law would be defeated by strict adherence to it. This is a relatively wide power that ASIC uses on a regular basis. Declarations granting the modification or relief from the CA can be class orders applying to a class or group in the regulated population, but can also be issued in the form of individual relief that apply only to a single entity or person. Class orders are legislative instruments that are subject to parliamentary scrutiny allowing either House of Parliament to disallow them.</p> <p>All class orders are published on the ASIC website. Individual relief instruments are also normally subject to publication. However, certain individual relief cannot be published due to the requirements of the law (e.g., reliefs on financial reporting (s340 CA) and auditor rotation (s342A CA)). According to ASIC staff, this is largely due to historic reasons. Any transparency concerns are alleviated by ASIC's practice to publish a quarterly report which provides an overview of situations where it has exercised, or refused to exercise, its exemption and modification powers. This report includes summarized information on the individual relief that were not published, if they contributed to a theme for a particular report. In addition, where a public company is</p>

involved, the substance of the relief will generally be made public because of continuous disclosure requirements and/or conditions of the relief imposed by ASIC.

The majority of regulatory decision-making in ASIC is carried out in accordance with published policies. These policies set out how ASIC interprets the law and how it approaches performing its functions and exercising its powers under the law. This includes, where appropriate, setting out what matters ASIC will take into account in making particular decisions.

Consistency of product regulation

ASIC is the only conduct and product regulator for financial services (including for banking and insurance services). The definition of financial product is broad, and all financial products are subject to the same regulatory requirements independent of their

issuer. Some formal differences may arise in the disclosure requirements in case an instrument would fall under the prospectus regime rather than under the PDS regime (see Principle 16).

Regulatory overlaps and gaps

In some areas, ASIC shares its regulatory responsibilities with APRA, the responsible Minister (or his delegate), the RBA and the SROs (in particular the operators of ASX Group clearing facilities).

Between APRA and ASIC, the main area of potential regulatory overlap arises as a consequence of ASIC having the supervisory role for all AFSL holders, which captures entities that are also regulated by APRA (banks, insurers and superannuation fund trustees). The regulatory framework aims at dealing with this overlap, firstly, by disapplying certain CA provisions for the AFSL holders that are also regulated by APRA (in particular, the ones relating to financial, technological and human resources and risk management procedures). Further, where the holder of an AFSL is subject to prudential regulation, ASIC must consult with APRA prior to imposing, revoking or varying any AFSL conditions or suspending or cancelling an AFSL, if the changes in ASIC's opinion could prevent the AFSL holder from carrying out its activities that are regulated by APRA. In other cases ASIC is required to inform APRA within a week of its action (s914A(4) CA). However, where the AFSL holder is an ADI, the powers conferred to APRA are exercised by the Minister (s914A(5) CA).

The Minister has the power to issue, vary, suspend or cancel an AML or CSFL; impose, vary or revoke conditions on an AML or CSFL; disallow all or part of proposed changes to the operating rules of an AML or a CSFL; and give directions to an AML or a CSFL holder where it is not complying with its license obligations. The Minister takes these actions after having received the advice of ASIC. The powers of the Minister are analyzed in more detail under Principle 2.

The CA distinguishes the role of ASIC and the RBA in relation to CSFL holders. The primary role of the latter is to set and monitor compliance with the Financial Stability Standards, which can be done for the purpose of ensuring that the CSFL holders conduct their affairs in a way that promotes the overall stability of the Australian financial system.

Finally, to the extent that a Market Participant is also a Clearing Participant, the roles of ASIC and the operators of the relevant clearing facilities (in practice ASX Clear and ASX Clear (Futures)) overlap since the latter are in charge of setting and monitoring the capital requirements of Clearing Participants, in which case their AFSL financial resources requirements are waived.

Cooperation and communication

	<p>The CA imposes a requirement on ASIC to communicate with APRA and the Minister in relation to a number of licensing matters. In addition, it has entered into Memoranda of Understanding (MoU) with APRA, ACCC and the RBA, respectively, to establish a framework for exchange of information and cooperation in areas of common interest.</p> <p>There is also an ASIC-APRA Joint Protocol that is intended to be read with the MoU. The protocol sets out an overview of the ASIC-APRA liaison structure, including the seniority of participants and frequency of meetings. The agencies meet every eight weeks for operational liaison meetings and quarterly for enforcement liaison meetings. ASIC and APRA have also developed guidelines to further improve the flow of information between the two agencies. There is some coordination of supervisory activities, including by sharing the respective plans, but joint inspections are rarely conducted.</p> <p>Pursuant to s127 of the ASIC Act, ASIC has the ability to release information to the Minister and APRA, RBA and some other domestic government agencies. The Chairman</p> <p>may impose conditions on the release of information (see Principle 13).</p> <p>Clarity of ASIC's responsibilities</p> <p>As noted above, the ASIC Act clearly determines the division of responsibilities between ASIC and APRA in case of AFSL holders that are also bodies regulated by APRA. In the case of those AFSL holders that are not APRA regulated bodies, it equally clearly assigns the full responsibility for their supervision to ASIC.</p> <p>In practice, ASIC's approach to the supervision of the entities that fall under its sole responsibility is different from APRA's. APRA's mandate as the prudential regulator is to ensure that under all reasonable circumstances, financial promises made by prudentially regulated entities are met within a stable, efficient and competitive financial system. This type of regulation involves prudential standards directed to ensuring prudent financial management of the supervised entities, and more intensive scrutiny of their operations and operating models.</p> <p>By contrast, ASIC's role is understood to be that of a conduct regulator, which means that it must ensure compliance with statutory obligations and other regulatory standards. According to ASIC, this means that it does not necessarily seek to ensure that entities under its supervision (in particular operators of collective investment schemes and market intermediaries) cannot fail or limit the possibility that they fail. Rather, such entities are regulated to ensure that they meet certain conduct and competency standards and have sufficient risk management mechanisms in place, and that in the event of a failure, client funds and property are adequately segregated and protected.</p> <p>In order to ensure compliance, ASIC however frequently uses prudential tools, such as the imposition and monitoring of capital requirements and risk management requirements. Given ASIC's view that the entities it regulates generally pose fewer risks (and in particular have less potential systemic impact) than the banks regulated by APRA, it generally applies and monitors prudential requirements less intensely than APRA does in relation to banks.</p>
Assessment	Fully Implemented
Comments	<p>From the perspective of the IOSCO Principles, there does not appear to be any lack of clarity in ASIC's responsibilities as defined by law. Neither do there appear to be any evident gaps in the coverage of the basic elements of securities regulation in Australia or the division of legal responsibilities for the supervision of various types of regulated bodies. The risks arising from the functional gaps are addressed in more detail under</p>

	<p>Principles 24, 30, 31 and 37.</p> <p>However, the division of responsibilities for the prudential supervision of AFSL holders between several regulatory authorities and CSFL holders has created a complex supervisory structure. This is further complicated by the fact that ASIC's primary role is that of a conduct regulator, while it – together with the CSFL holders – is effectively in charge of the overall supervision of many important market intermediaries with the potential of having, solely or as a group, systemic impact on the Australian securities markets.</p> <p>The dispersion of regulatory roles might lead to unjustified differences in supervisory practices and lack of a market level overview of the risks arising from the participants in securities markets. Smooth cooperation between the authorities (APRA, ASIC, ASX Clear and RBA) is therefore essential for the functioning of the current model. Going forward, the authorities should ensure that the current regulatory set-up continues to best ensure the protection of investors and the reduction of systemic risk. This relates in particular to considering whether the responsibilities for prudential supervision are appropriately allocated.</p> <p>ASIC has adopted a transparent policy for the publication of its relief instruments, including individual reliefs. However, it is recommended that the authorities consider the continued appropriateness of the legal prohibitions to publish certain individual reliefs to provide the maximum transparency possible.</p>
Principle 2.	The regulator should be operationally independent and accountable in the exercise of its functions and powers.
Description	<p>Role of the Minister</p> <p>The Minister responsible for ASIC is the Treasurer, assisted by the Minister for Financial Services and Superannuation and the Parliamentary Secretary to the Treasurer. Ministerial responsibility for superannuation, financial services, credit and financial markets has been allocated to the Minister for Financial Services and Superannuation, whereas the Parliamentary Secretary of the Treasurer is in charge of corporate governance, audit, insolvency, financial literacy and the administration of ASIC.</p> <p><i>Directions from the Minister</i></p> <p>The Minister may give a written direction to ASIC on policies it should pursue and priorities it should follow in performing or exercising any of its functions or powers under the corporations legislation (s12 ASIC Act). Before issuing a direction, the Minister must provide notice of the proposed direction to the ASIC Chairman, who has to be given adequate opportunity to discuss the need for the proposed direction with the Minister. Where the Minister does issue a direction, he is required to publish a copy of the direction in the Government Gazette within 21 days and table the direction in both Houses of Parliament within 15 sitting days of the publication of the direction (s12(5) ASIC Act).</p> <p>The Minister is prevented from giving a direction under s12 of the ASIC Act with reference to a particular case (s12(3) ASIC Act). However, the Minister can direct ASIC to investigate a particular matter when he/she considers it to be in the public interest (s14 ASIC Act). The conduct of that investigation and any decisions to be made (for example, whether to commence proceedings or whether to conclude the investigation) are matters for ASIC.</p> <p>The Minister noted in his 2007 Statement of Expectations to ASIC (see below) that the use of the directions power would only be considered in rare and exceptional circumstances. The only time that a direction has been made was in 1992, where the</p>

Minister directed ASIC under s12 of the ASIC Act to develop and implement policy for the discharge of its powers vis-à-vis those of the Commonwealth Director of Public Prosecutions.

Statement of Expectations

The Review of the Corporate Governance of Statutory Authorities and Office Holders released in June 2003 (Uhrig Report) recommended that ministers clarify expectations by issuing public Statements of Expectations to statutory authorities, taking into account their nature of independence. A Statement of Expectations is intended to allow a Minister to provide greater clarity about government policies and objectives relevant to a statutory authority, including the policies and priorities it is expected to observe in conducting its operations. Statutory authorities respond with Statements of Intent for approval by ministers.

A Statement of Expectations to ASIC was issued in February 2007. It highlighted, among others, the importance of administering the regulatory regime in a manner that minimizes procedural requirements and business costs. It also expressed the Government's preference for regulation to identify the outcomes that are desired rather than prescribe how to achieve those outcomes. It required ASIC to copy all information, briefings, press releases and correspondence it provides to Ministers to the Secretary to the Treasury.

In its Statement of Intent given in response to the Minister, ASIC expressed its agreement with the substance of the Statement of Expectations. However, it emphasized its position as an independent agency and noted that its undertaking to provide information to the Treasury is subject to that position and other legislative requirements which may limit ASIC's ability to provide such information to the Treasury.

Licensed markets and clearing and settlement facilities

Certain supervisory decisions relating to holders of AMLs and CFSLs are conferred on the Minister (see Principles 1 and 33). The Minister must also approve the Market Integrity Rules (MIRs) prepared by ASIC that deal with licensed markets, the activities and conduct of persons in relation to those markets, and financial products traded on them. The process that ASIC must follow to obtain Ministerial consent for the MIRs is set out in the CA (s798G).

In case ASIC has given written advice to an AML or CSFL holder of its intention to give it a specified direction, the latter may request in writing that ASIC refer the matter to the Minister. In this case ASIC must do so immediately. The Minister may, if he or she considers it appropriate, require ASIC not to make, or to revoke, the direction; ASIC must immediately comply with this requirement (s794D or s823D of the CA). In February 2012, the CFR requested in its letter to the Deputy Prime Minister and Treasurer on the review of financial market infrastructure regulation that the process by which ASIC can give directions to AML and CSFLs be streamlined so as to facilitate more rapid and certain actions either in a financial or operational distress situation or in the event of a significant breach of license conditions.

Independence from commercial or other sectoral interests

ASIC has a formal and open consultation procedure for new policy proposals. All discretionary procedures, such as licensing financial services providers and granting individual and class relief from the law, are subject to legislative requirements that are supplemented by ASIC's own regulatory guidance.

ASIC's Regulatory Policy Group (RPG) composed of ASIC Commissioners and senior ASIC staff makes decisions about its regulatory policy and provides guidance on novel relief applications. For less novel matters it is common practice for there to be at least two people considering relief applications - an "action officer" and a supervisor. Further,

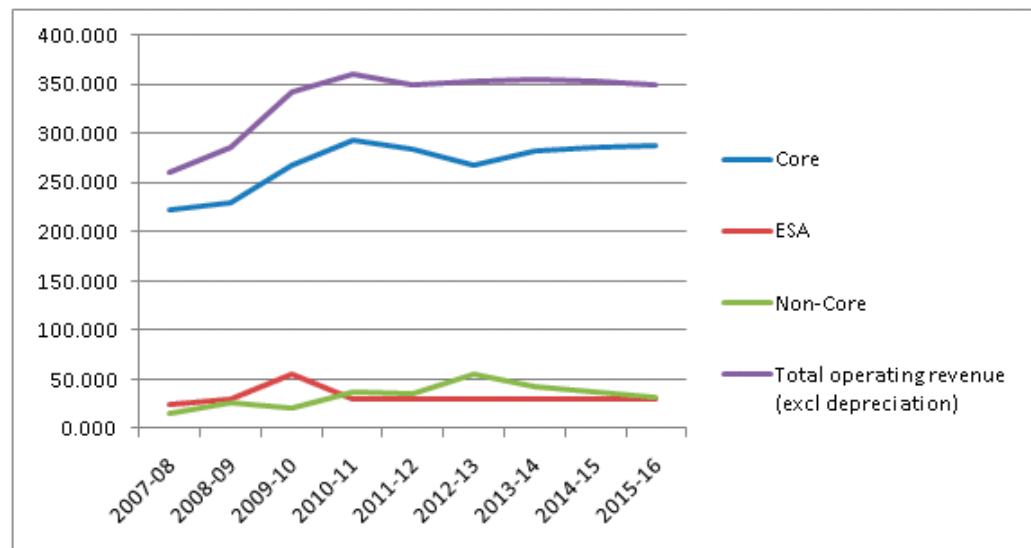
as explained under Principle 1, most of the relief decisions are made public.

In addition, ASIC and members of its staff must avoid situations where external or personal interests may conflict, or appear to conflict with ASIC's administration or enforcement of the ASIC Act, the CA or other legislation. This is administered through the Declarations of Interest Program.

Stable and continuous source of funding

The funding of ASIC is appropriated to it each financial year by the Parliament and provided from the Commonwealth's Consolidated Revenue Fund under Appropriations Bill. Although ASIC raises revenue for Government through fees and charges on those it regulates, it does not retain that revenue. Almost all fees and charges collected by ASIC are returned to the Commonwealth Consolidated Revenue Fund. In 2010-11, ASIC raised A\$622 million in fees and charges. The small amount retained is on top of the funding ASIC receives as part of its annual departmental appropriations and is not a determinant of the level of annual appropriation received by it (between fiscal years 2007-08 and 2010-11, this amount has varied between A\$ 7 and 24 million).

Development in ASIC's Non-depreciation Funding 2007-2016



Source: ASIC

The graph demonstrates a sharp increase in core funding³ in 2009-10 which diminishes in the following years. This funding increase related to the Global Financial Crisis. The core funding reduction in 2010-11 and 2011-12 was offset by receipts from fees and charges referred to above that however are not a stable and predictable source of funding. Since the fiscal year 2006-07 ASIC has also been allocated with Enforcement Special Account (ESA) funding for running major cases.

The graph also shows the overall increase in non-core funding⁴ since 2007-08 which is funding earmarked for new policy proposals, other special projects and new initiatives proposed by ASIC (such as Credit Reform and Market Supervision). This trend continues in the 2012-13 budget allocation where the core funding drops by A\$17.5 million, while non-core funding increases by A\$19.5 million. This increases the share of non-core funding to 23.9 percent of ASIC's funding from previous year's 18.7 percent.

³Core funding is funding the allocation and use of which is a matter for ASIC (within some limitations).

⁴Non-core funding is funding allocated for specific purposes.

However, non-core funding will decrease from that level after 2012-13, with a corresponding increase in ASIC's core funding. As demonstrated by the above graph, ASIC's non-core funding is projected to decline from the fiscal year 2013-14 onwards (to nine percent of total operating revenue by 2015-16), with total operating revenue largely maintained through the increase in core funding.

Even though it has been indicated that the delineation between 'core' and 'non-core' funding has no legal or accounting basis in the appropriation framework used to fund ASIC, in practice ASIC does not use the funds earmarked for specific purposes to fund any other activities.

Since 1 August 2010, a market supervision and competition cost recovery regime applicable to certain AMLs and the participants of ASX and Chi-X has been in place. This regime is a mechanism for the Australian Government to recover additional funding it had approved to cover ASIC's additional costs for undertaking its new regulatory functions following the transfer of market supervision to ASIC (on 1 August 2010); the introduction of market competition in equity securities; and the one-off cost associated with the development of a framework to support market competition.

Bona fide legal protection

S246 of the ASIC Act provides that ASIC, its Commissioners and its staff are protected from legal liability in relation to an act done or omitted in good faith in performance or purported performance of any function, or in exercise or purported exercise of any power, under the corporations legislation or a prescribed law. According to ASIC, from a practical perspective it is unlikely that ASIC staff would be sued in connection with the discharge of their obligations. In the event that a staff member was sued in relation to his/her employment, the Australian Government would cover the legal costs (unless it was in relation to an administrative law issue, in which case ASIC would cover the legal costs).

Protection of independence of head and governing board

ASIC's Commissioners are appointed by the Governor-General of the Commonwealth of Australia upon a nomination from the Minister (s9 ASIC Act). Their term can be up to five years and they are eligible for reappointment (s108 ASIC Act). The grounds on which the Governor-General can terminate a Commissioner's appointment are set out in s111 of the ASIC Act and include misbehaviour, physical or mental incapacity and bankruptcy.

Accountability

ASIC is subject to a number of formalized processes to ensure its accountability. For example, it reports to the Federal Parliament, the Treasurer and the Parliamentary Secretary to the Treasurer. It needs to appear before some parliamentary committees on a regular basis, the most relevant of which is the Joint Parliamentary Committee on Corporations and Financial Services that inquires into and reports to both Houses of Parliament on the activities of ASIC and the Takeovers Panel. Twice a year ASIC appears before the Senate Estimates Committee, which inquires into the expenditure of public money by Government departments and agencies. In addition, ASIC's activities may be subject to review by ad hoc committees.

ASIC is required to publish an annual report, including audited accounts, which is tabled in Parliament and provided to various parliamentary committees. ASIC also publishes information on its regulatory actions on its website.

ASIC is subject to the Financial Management and Accountability Act 1997 in respect of the public money that it holds. Internal audits conducted by ASIC's Audit Committee are intended to identify, monitor and review the effectiveness and integrity of ASIC's risk management and internal control frameworks, the truth and fairness of ASIC's financial reporting and ASIC's compliance with relevant legislation. ASIC also has an Audit,

	<p>Assurance and Compliance (AA&C) Unit which provides independent reviews, objective assurance and advisory services to the Commission. An external audit review is conducted through the Australian National Audit Office.</p> <p>The Freedom of Information Act (FOI Act) provides that, unless an exemption applies, a government agency is to provide a member of the public with access to information held by the agency (s11 FOI Act). An exemption could apply, for example, if disclosure would prejudice the conduct of an investigation (s37 FOI Act) or a document contains material obtained in confidence (s45 FOI Act).</p> <p>Procedural fairness</p> <p>ASIC is required to give reasons in writing for its decisions if the affected person is entitled to seek review of the decision. In addition, as a matter of sound regulatory practice, ASIC normally provides reasons in its decisions even if there is no statutory obligation to do so.</p> <p>As a matter of common law in Australia, persons making administrative decisions under statutes are also required to afford procedural fairness to persons who may be adversely affected by those decisions. This includes a hearing rule requiring the decision maker to give affected persons (including third persons, where relevant) an opportunity to present their case as well as an impartiality requirement. In addition, some of ASIC's statutory powers are subject to specific legislative requirements to give potentially affected persons an opportunity to make submissions to ASIC before a decision is made.</p> <p>There is no requirement in the CA for the Minister to give an applicant a hearing before refusing to grant the applicant an AML. However, the Minister is subject to the general principles of procedural fairness that require that a person whose interests are adversely affected by a decision be given the opportunity to make submissions.</p> <p>ASIC's decisions are generally subject to judicial review as to their legality (e.g., errors of law or lack of jurisdiction) under the Administrative Decisions Judicial Review Act 1977 (ADJR Act). Most decisions of a regulatory nature are also subject to merits review by the Administrative Appeals Tribunal (AAT). A small number of regulatory decisions are not subject to merits review (s1317C CA). In addition, there are a few other decisions that are not reviewable for merits, e.g., decisions relating to a process where the rights of the affected party are otherwise protected. Most of the decisions under the ASIC Act are related to steps ordinarily taken in an enforcement process (e.g., decisions to start an investigation) and therefore not subject to merits review.</p> <p>The AAT may affirm ASIC's decision and substitute it with a different decision. S44 of the AAT Act enables appeal to the Federal Court from decisions of the AAT on questions of law. Finally, the Supreme Courts of the Australian States and Territories and the High Court of Australia also have jurisdiction to review ASIC's decisions.</p> <p>The decisions of the Minister are also subject to both a merits and judicial review.</p> <p>Decisions to grant relief from the takeovers provisions are reviewable by the Takeovers Panel (s656A CA). ASIC's actions are also generally subject to review by the Commonwealth Ombudsman. The Ombudsman may make recommendations to ASIC about what action should be taken, but unlike the AAT, it does not have the power to change ASIC's decisions.</p> <p>A person who is entitled to seek review of a decision under the ADJR Act may request from the decision maker a statement setting out findings of material questions of fact, evidence on which those findings were based and the reasons for the decision. A person seeking merits review in the AAT is also entitled to a statement of reasons after filing proceedings.</p> <p>Where a merits review proceeding has commenced in the AAT, application can be</p>
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	made for restricting the disclosure of sensitive evidence. Similarly, the Federal Court can make confidentiality orders in relation to evidence tendered in judicial review proceedings (s50 Federal Court of Australia Act 1976). Disclosure of confidential information by ASIC is governed by s127 of the ASIC Act.
Assessment	Partly Implemented
Comments	<p>Several elements of the Australian regulatory framework need to be carefully considered in order to assess the extent of independence of ASIC. In light of Key Questions 2 and 4 of the IOSCO methodology, they relate in particular to the following.</p> <p>The relevant Minister has been provided with a series of powers ranging from the possibility to give directions to ASIC under the ASIC Act to being in charge of certain supervisory decisions in the case of market infrastructure. The use of these powers is generally subject to a clear and transparent process and decisions relating to market infrastructure are made on the basis of the advice of ASIC. Most of these powers have been rarely, if ever, used, and they do not generally include decision-making on day-to-day technical matters. However, the extent of these powers remains a concern.</p> <p>ASIC is dependent on appropriations from the Government budget in its funding. A not insignificant amount of its funding is non-core earmarked for specific projects. The relative share of this non-core funding has been increasing in the last few years, with the budget for 2012-13 continuing this trend. This raises concerns about the stability of ASIC's core funding at the same time where it has been assigned new permanent responsibilities. Concerns about the sufficiency of ASIC's funding are analysed in further detail under Principle 3.</p> <p>ASIC's non-core funding is projected to decline from the fiscal year 2013-14 onwards. This is an encouraging development, but does not seem to go far enough to guarantee sufficient financial independence of ASIC. It is recommended that the authorities consider alternative possibilities to arrange the funding of ASIC in such a manner that it will be best equipped to respond to the current and emerging challenges in securities regulation both domestically and globally.</p>
Principle 3.	The regulator should have adequate powers, proper resources and the capacity to perform its functions and exercise its powers.
Description	<p>Powers</p> <p>ASIC exercises a number of powers defined in the ASIC Act and the CA. Among others, it:</p> <ul style="list-style-type: none"> • registers companies and MIS; • grants AFSLs; • registers auditors and liquidators; • grants relief from various provisions of the legislation administered by ASIC; • modifies and exempts the laws it administers, where appropriate; • administers the disclosure requirements for financial products and services in Chapter 7 of the CA and stops the issue of financial products under defective disclosure documents; • maintains publicly accessible registers of information about companies, AFSL holders and ACL holders; • makes rules aimed at ensuring the integrity of financial markets; • investigates suspected breaches of law and in doing so requires people to produce books or answer questions at an examination;

- issues infringement notices in relation to alleged breaches of some laws;
- bans people from engaging in credit activities or providing financial services;
- seeks civil penalties from the courts;
- commences prosecutions;
- monitors and regulates corporate activity such as financial reporting, prospectus fundraising, and takeover activity;
- conducts real-time supervision of market participants; and
- educates and informs retail investors and consumers.

ASIC has also an incidental power to do whatever is necessary for, or in connection with, or reasonably incidental to, the performance of its functions (s11(4) and 12A(6) ASIC Act).

Apart from making MIRs, ASIC does not have a rule-making power under the CA. However, as highlighted under Principle 1, it can use RGs and class orders to interpret the law in a relatively flexible manner. In the view of market participants, ASIC's RGs have effectively the same impact on behaviour as binding regulations.

Funding

The regulated population of ASIC and the number of staff responsible for the regulation and supervision of each category is the following.

ASIC Team	Number of staff (as at May 2012)
Markets	
<i>Corporations</i>	58
1.84 million registered companies ⁵	
2,216 listed corporations	
<i>Exchange Market Operators</i>	28
17 AMLs	
5 CSFLs	
19 exempt markets	
98 low volume exempt markets	
<i>Financial Reporting and Audit</i>	33
5,077 registered company auditors	
4 large audit firms auditing listed entities	
111 other audit firms auditing listed entities	
<i>Market and Participant Supervision</i>	54
137 Market Participants	

⁵The team focuses on the supervision of large and complex transactions by listed entities.

Approximately 700 active Indirect Market Participants	
Supervision of trading on 6 markets	
<i>Insolvency Practitioners</i>	28
670 registered liquidators	
Investors and Financial Consumers	
<hr/>	
<i>Investment Managers and Superannuation</i>	44
585 responsible entities	
4,500 registered CIS	
230 super fund trustees	
680 custodial service providers	
<i>Investment Banks</i>	26
25 investment banks	
500-600 hedge funds	
44 retail OTC derivative issuers	
6 credit rating agencies	
<i>Consumers, Advisers and Retail Investors</i>	70
3,345 AFSL holders authorized to provide personal financial advice.	
<i>Deposit-takers, Consumer Credit and Insurers</i>	64
180 ADIs	
6,081 credit providers	
Total	397
<hr/>	
<p>As indicated by the above table, ASIC's supervisory responsibilities extend beyond securities regulation, in particular in relation to deposit-takers, consumer credit, insurers and superannuation trustees. In addition to the approximately 400 staff directly responsible for various areas, the deterrence (enforcement) functions of ASIC have a total staff of 256. The registry and licensing function has a staff of 430, out of which approximately 230 are in charge of company registry services and 43 of the licensing function. With the support services and centralized functions, the total staff of ASIC is close to 1900.</p> <p>The funding structure of ASIC has been presented under Principle 2. As highlighted there, ASIC's funding is split into core and non-core funding. It is largely able to specify the operational allocation of core funding of resources, whereas non-core funding must be spent on the activities for which it is allocated. ASIC is of the view that measured in terms of the level and outcomes of interaction with the regulated population and the outcomes of enforcement activity, current funding levels are adequate. It also considers that the current allocation of staff between various areas is appropriate. Many market participants interviewed during the assessment referred to the fact that the achievements of ASIC are reasonably good given the limited resources at its disposal. At the same time, ASIC considers that the future developments in the growth and</p>	

complexity in financial markets will provide further challenges to ensure that its funding remains adequate.

Capacity to attract and retain qualified staff

ASIC's remuneration arrangements were benchmarked against all Australian Public Service (APS) agencies in August 2011. Senior Executives are paid 10-20 percent above the APS median, while more junior roles sit at the median of the APS pay scales. In addition to base salary, ASIC staff is also eligible to receive performance based bonuses ranging from 3 to 15 percent.

As of November 2011, ASIC's ongoing employee turnover rate was 12.5 percent (a rolling 12 month average), an increase of 3.6 percent from the previous year. In ASIC's recent internal survey, the level of self-reported staff retention over the next two years is 59 percent (higher than the 44 percent for large APS agencies) and 20 percent of staff indicated they intend to leave within the next two years. ASIC's management was of the view that the staff turnover is currently at a healthy level.

Training

In 2010-2011, ASIC spent around A\$1.4 million on formal learning programs. It can also support staff's studies both financially (up to A\$5000/year) and through study and leave entitlements. ASIC has developed a set of learning pathways, representing the main skill areas that the staff requires in order to effectively perform their roles, aligned with ASIC's business needs. In addition to these learning programs, seminars and other learning opportunities are offered as part of the Continuing Professional Development Program.

Governance

ASIC has a Corporate Governance Charter that outlines its internal governance structure and delegation of responsibilities. ASIC is headed by a full-time Commission that is responsible for the strategic direction and operations of ASIC. It currently has five Commissioners, including the Chairman and Deputy Chairman. The Commission meeting, normally held monthly, is a decision-making forum on significant strategic issues and on other matters as determined by the Chairman. The ASIC Act sets out the functions and powers, and the statutory governance requirements for ASIC, including how and to whom the Commission and its members can delegate their functions or powers.

The management of ASIC and decision making outside the Commission meetings are the responsibility of the Chairman. With the Chairman, each Commissioner is responsible for ASIC's performance of its statutory functions, operations, strategic direction and priorities. In addition to the above functions, each Commissioner has responsibility for reporting to the Commission (and between Commission meetings, to the Chairman) on the work of the specific stakeholder teams and working groups for which he/she is responsible, as designated by the Commission. Each Commissioner is responsible for determining the scope and authority of the Senior Executive Leaders (SELs) within his/her area of responsibility. Within their designated areas of responsibility, and having regard to ASIC's framework for decision making, SELs are responsible for the day-to-day operation of ASIC. The SELs establish lines of authority and responsibility with their respective Commissioners for decision making within their group.

ASIC has policies and workflows for particular areas (e.g., enforcement and licensing). Specific ASIC business units have documentation in place to guide staff in conducting day-to-day work. ASIC's Audit Committee provides independent oversight of, and reporting to, ASIC's Chairman and the Commission regarding ASIC's risk management and internal control frameworks, the truth and fairness of its financial reporting and its compliance with relevant legislation. The Audit Committee Chairman, Deputy Chairman

	<p>and one other member are appointed from outside ASIC. An ASIC Commissioner and senior executive from ASIC are also members.</p> <p>Investor education</p> <p>ASIC is responsible for promoting the confident and informed participation of consumers and investors in the financial system (s1(2) ASIC Act). For this purpose, it is working to implement a National Financial Literacy Strategy and other initiatives. The former includes four main work streams (delivering financial literacy programs; ensuring access to independent information and tools; looking beyond education to solutions that promote financial wellbeing; and developing partnerships with industry and the community).</p>
Assessment	Partly Implemented
Comments	<p>Key Question 2.(a) of the Methodology requires the regulator's funding to permit it to fulfil its responsibilities, taking into account the size, complexity and types of functions subject to its regulation and supervision. ASIC has been assigned a significant amount of new responsibilities over the past few years. At the same time, its funding is expected to remain at approximately the same level for a third consecutive year in 2012-13. The regulatory challenges ahead are significant, given for example the introduction of competition in trading, the reform of financial advice, and global regulatory commitments to harmonize and strengthen the regulatory framework in many important areas, including shadow banking and OTC derivatives.</p> <p>Against the above background, since in practice non-core funding can be used only for the purpose for which it is granted, ASIC cannot effectively decide on the operational allocation of a significant part of its resources. This is inconsistent with the requirement of Key Question 2.(b) of the Methodology. As highlighted under Principles 12, 24 and 31, resources allocated by ASIC to proactive supervision are very limited and leave a significant part of the regulated population subject only to reactive supervision. An increase in financial resources would better equip ASIC to meet the challenges it is facing.</p> <p>ASIC has an extensive range of powers, and although its power to issue rules is currently limited to MIRs, it has been able to build a credible regulatory framework using the tools available to it under the CA.</p>
Principle 4.	The regulator should adopt clear and consistent regulatory processes.
Description	<p>Policy development process</p> <p>ASIC consults with the public and other government bodies on new policy proposals through formal and informal consultation procedures. Early in the process of developing new policy, ASIC often seeks to hold informal roundtable discussions with representatives from industry and consumer advocacy groups. ASIC also funds a Consumer Advisory Panel that comments on policy affecting investors and consumers and an External Advisory Panel that it consults on key issues. It also maintains regional liaison committees in each State and Territory to consult the local business community. ASIC generally circulates a consultation paper before finalizing new or revised policy, and deviates from this approach only for reasons of urgency. ASIC's policy development process is subject to the Australian Government's Regulatory Impact Analysis process that entails examining the likely impacts of proposed regulation. Following consultation, it prepares a Regulatory Impact Statement (except in issues of minor and mechanical nature) that is reviewed by a government agency called the Office of Best Practice Regulation (OBPR). ASIC publishes the RIS and a report on its response to feedback received together with the final RG.</p> <p>ASIC also makes use of media releases to disclose and explain regulatory actions and the adoption of new or revised standards. It has published its policy on the areas where</p>

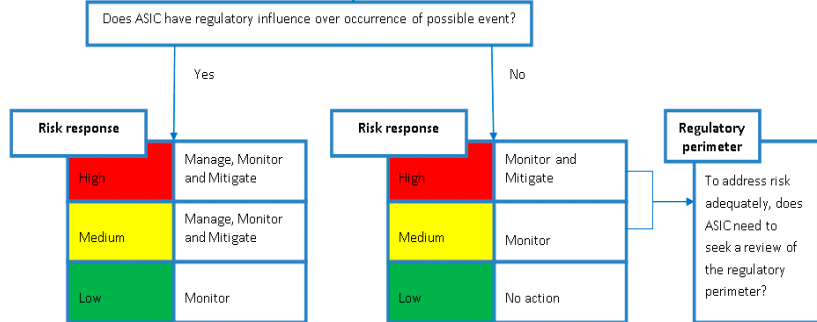
	<p>it issues media releases. The ASIC website includes reports, RGs, Market Integrity Rules (MIRs) and relief instruments issued by ASIC and provides links to the legislation which ASIC administers.</p> <p>ASIC provides a significant amount of information on its website on its regulatory policies, including on the way it prepares new policy.</p> <p>The Governor-General, on the advice of the Executive Government, can issue regulations applicable to securities markets. The making of regulations by the Governor-General is subject to the same procedural requirements that apply to the making of MIRs and other legislative instruments by ASIC, including consultation and RIA.</p> <p>Procedural fairness</p> <p>The procedural fairness requirements applicable to ASIC are addressed under Principle 2.</p> <p>Decisions on AFSL licenses</p> <p>The criteria for granting or denying a licence are specified in the CA. For example, in relation to the issue of an AFSL, s913B of the CA requires ASIC to grant such a licence if certain requirements are met. ASIC can refuse to grant an AFSL only after the applicant has been provided with an opportunity to appear and be represented at a private hearing before ASIC.</p> <p>The process for suspending or revoking an AFSL is also specified in the CA. In most cases, an AFSL holder will be provided with an opportunity to appear at a hearing before ASIC, prior to ASIC suspending or revoking the AFSL. It is only in extreme circumstances (e.g., insolvency) that ASIC can act without providing the AFSL holder with an opportunity to be heard.</p> <p>Transparency and confidentiality</p> <p>Section 127(1) of the ASIC Act provides that ASIC is to take reasonable measures to protect from unauthorized disclosure confidential information or information that it has obtained in the course of carrying out its functions, including an investigation. In addition, this information is subject to the Privacy Principles set out in s14 of the Privacy Act. ASIC's policy about commenting publicly on investigations is published in ASIC's Information Sheet no. 152. ASIC may make statements about an investigation when it is in the public interest to do so. When considering whether to make a statement about an investigation it will weigh up any potential public benefits against the potential prejudice that may be caused to any individuals who are, or who are likely to be, subject to an investigation.</p> <p>If the Minister were to direct ASIC to investigate a matter under section 14 of the ASIC Act, ASIC would need to prepare a formal report on the investigation. Details of ASIC's investigation would be disclosed by the Minister. According to the ASIC Act, the Minister may also cause any report on an investigation, or part of it, to be published (s18 ASIC Act). However, this power has limited practical significance, since ASIC does not normally prepare formal reports on its investigations. Instead, it either takes action under its own powers or prepares a brief of evidence for the CDPP.</p> <p>Consistent application of powers</p> <p>ASIC has a number of processes and systems to ensure that it can discharge its functions and powers consistently across its regulated population. These include internal manuals and guides as well as organizational arrangements and allocation of responsibilities to ensure sufficient coordination and consistency. See also Principle 3.</p>
Assessment	Fully Implemented

Comments	
Principle 5.	The staff of the regulator should observe the highest professional standards, including appropriate standards of confidentiality.
Description	<p>Code of conduct</p> <p>The ASIC Act requires ASIC Commissioners to disclose a direct or indirect pecuniary or other interest that could conflict with the proper performance of their decision-making functions in relation to a particular matter (s124(2) ASIC Act). More generally, all ASIC staff are required under the Public Service Act and internal ASIC policy to disclose and take reasonable steps to avoid any conflict of interest (real or apparent) in connection with their employment and not make improper use of inside information. They are also subject to an ongoing conflict disclosure obligation.</p> <p>Under the ASIC Act, the Commissioners are required to disclose to the Minister every six months any relevant pecuniary interest, including in financial products regulated by ASIC. Staff are required to complete a disclosure of interest form on financial interests and on any outside employment upon commencement of employment and biannually thereafter. Since September 2011, ASIC internal policy has also prohibited trading by ASIC staff members most likely to handle market sensitive information, unless pre-trading approval has been obtained from ASIC's Risk and Security Unit, which compares the trading request to a restricted list of entities and products.</p> <p>The use, collection, access, accuracy, security, storage and disposal of official information are governed by a number of Commonwealth Acts and Regulations. All staff must acknowledge their awareness of the existence and implications of this legislation upon commencement of their employment with ASIC. Section 127(1) of the ASIC Act requires ASIC to take reasonable measures to protect confidential information from unauthorized disclosure. ASIC and its staff are also subject to the Privacy Act that requires them to observe standards governing the handling of personal information. If an ASIC staff member releases information in breach of these provisions, it might constitute a breach of the Australian Public Service (APS) Values and the APS Code of Conduct. Any breach might lead to disciplinary action by ASIC and could be punishable by imprisonment for up to two years under s70 of the Crimes Act, if s13 of the Public Service Act has been breached.</p> <p>As described under Principle 2, ASIC has an obligation to afford procedural fairness when it proposes to make a decision which may adversely affect a person's rights, interests or legitimate expectations. If a staff member did not afford procedural fairness, ASIC's decision would be at risk of being challenged, in which case there would be a need to consider whether the omission of the staff member constituted a breach of the APS Values or APS Code of Conduct.</p> <p>Enforcement of the code of conduct</p> <p>Compliance with the code of conduct is monitored by ASIC's Risk and Security Unit. As required by s15 of the Public Service Act, ASIC has issued procedures for investigating and resolving breaches of the APS Code of Conduct. It has also published an Information Sheet that sets out how complaints are handled, with an internal guide covering investigation of allegations of misconduct. ASIC has a Professional Standards Unit (which reports to Commission Counsel) which reviews complaints about staff conduct in connection with ASIC's regulatory activities. In the event that an employee breaches the APS Code of Conduct, section 15(1) of the Public Service Act provides that the Chairman of ASIC can impose a range of listed sanctions (including termination of employment).</p>
Assessment	Fully Implemented

Comments	
Principle 6.	The Regulator should have or contribute to a process to monitor, mitigate and manage systemic risk, appropriate to its mandate.
Description	<p>Process to identify and monitor systemic risk</p> <p>Monitoring, mitigating and managing systemic risk is not a responsibility explicitly included in ASIC's legislative mandate. However, it has aimed at establishing processes for addressing systemic risk. Most notably, in July 2011 it established the Emerging Risk Committee (ERC) that is a cross-organizational group meeting on a monthly basis. The permanent members of the ERC are from various areas of ASIC with expertise in the analysis of emerging risks from the whole organisation's perspective. It is chaired by a Commissioner. Permanent members include the Chief Economist and high level representatives from Deterrence, Misconduct and Breach Reporting, Chief Legal Office and International Strategy. ASIC Commissioners are invited to attend the meetings, and they often do. The key purpose of the ERC is to channel senior level advice from within the organization to help ASIC gain a deeper understanding of emerging risks within the financial services industry that are likely to have implications across all regulatory activities. The ERC reports to the full Commission on a monthly basis.</p> <p style="text-align: center;">ERC Risk Assessment Framework</p> <div style="display: flex; justify-content: space-between;"> <div style="width: 30%;"> <p>Step 1: Identify potential harm</p> <hr/> <p>Step 2: Categorize risk</p> <hr/> <p>Step 3: Rate risk</p> </div> <div style="width: 65%;"> <pre> graph TD Start[Identify the possible event and articulate the potential harm arising from the event] --> Q1{Emerging Risk? Is ASIC effectively addressing the possible or past occurrence of the event and the potential harm?} Q1 -- Yes --> ER[Existing Risk: Not an emerging risk; adequacy of risk response is responsibility of SELs] Q1 -- No --> Q2{Systemic Risk? Does the harm involve an impairment of the financial system that will lead to major economic disruption?} Q2 -- No --> Q3{Product/ Sector Risk? Does the harm jeopardize confident and informed investors and financial consumers, fair & efficient markets, or efficient registration & licensing with effects that extend beyond a single firm?} Q3 -- No --> FLER[Firm Level Effects/Risks: Potential harm is to be risk rated and managed by SELs] Q2 -- Yes --> Rate[What is the risk rating of possible event using: • Consequences of the event on ASIC's priorities of: ○ confident and informed investors and financial consumers; or ○ fair & efficient markets; or ○ efficient registration & licensing; And • Likelihood of the event occurring] Q3 -- Yes --> Rate Rate --> PR[Perform risk rating] </pre> </div> </div>

Likelihood	Consequence : Impact on ASIC's Priorities Note: systemic risks will always have an extreme impact				
	Negligible	Minor	Moderate	Major	Extreme
Almost Certain	Low	Medium	High	High	High
Likely	Low	Medium	Medium	High	High
Possible	Low	Low	Medium	Medium	High
Unlikely	Low	Low	Medium	Medium	Medium
Rare	Low	Low	Low	Medium	Medium

Step 4: Determine response



The ERC uses the risk assessment framework to assess emerging risks and determine appropriate responses to identified risks. At each meeting, a different regulated population is assessed. Therefore each stakeholder team responsible for oversight of the particular regulated population will be represented on a regular basis in the ERC meetings. The ERC process is intended to encourage the stakeholder teams responsible for the supervision of various regulated populations to consider what systemic risks (as opposed to day-to-day risks) may impact their regulated populations.

Examples of the systemically relevant issues that the ERC has recently focused on include the risk of a second global financial crisis and a collapse in the Australian residential property market and its impact on Australian banks. Even though the ERC was established only recently, the staff of ASIC was of the view that it has assisted ASIC in focusing its thinking on emerging risks, which could also include risks with potential systemic implications. As an example of an outcome of the ERC work, the staff mentioned the recent review of ASIC’s business plans as a result of the discussions in the ERC on the deteriorating economic outlook. The Office of the Chief Economist also provides economic and financial data and analysis required for key strategic decision-making, including in relation to managing systemic risk.

Expertise

ASIC is developing expertise on risk measurements and analysis relevant to systemic risk within the Office of the Chief Economist and through the ERC. In addition, the stakeholder teams continue to develop frameworks around ASIC’s risk-based surveillance approach. This involves looking at the whole regulated population and deciding which entities are high risk (and warrant greater oversight) and which are lower risk (and warrant less oversight). Teams must continually update these risk assessment frameworks. They are currently at varying stage of development across the different stakeholder teams. Some of them focus on identifying thematic risks, while others have more focus on risks arising from individual firms.

Cooperation with other regulators

ASIC works with other domestic regulators to monitor, mitigate and manage systemic risk via its membership in the Council of Financial Regulators that meets four times per

	<p>year. In this capacity, it has briefed other CFR agencies on the establishment of the ERC and its workings. As yet, there has been no need to require any specific matter raised in the ERC to be included as an agenda item for discussion at the CFR. In the CFR meetings, ASIC representatives' contributions are informed by ERC discussions, as appropriate.</p> <p>As explained in the introduction and in more detail in Principle 30, ASC Clear and ASX Clear (Futures) have an important role in setting and monitoring the capital requirements of Clearing Participants. In case of concerns about a particular participant, they can alert ASIC accordingly. Due to the potential systemic risks arising from the clearing activities, they also cooperate with the RBA whose task is to ensure that CFSL holders conduct their affairs in a way that promotes the overall stability of the Australian financial system.</p> <p>In addition, as a reaction to the global financial crisis the Treasury has set up a regular contact schedule with staff from APRA, the RBA and ASIC to share information on economic and market developments that are of systemic importance to the Australian financial sector and to develop ideas as to how to respond to the crisis. These contacts happen in an informal manner through regular conference calls.</p>
Assessment	Fully Implemented
Comments	<p>Key Question 1 of the Methodology requires a regulator to develop a process (or contribute to a process) to monitor systemic risk appropriate to its mandate. The guidance provided by IOSCO for this Principle, and in particular this question, is limited. Furthermore, contributing to a process to identify and manage systemic risk is in many ways a 'new' function for securities regulators, as in practice their concerns have mostly been about investor protection issues. Thus best international practices have not yet developed. This makes the assessment of this Principle challenging. As IOSCO develops additional guidance, and practices mature, there will be additional critical input to judge in a more granular way the level of implementation of this Principle.</p> <p>The key issues that have been taken into consideration for purposes of evaluating compliance with Key Question 1 are (i) whether there are specific arrangements in place whose objective is the identification of systemic risk; (ii) whether such arrangements allow for a holistic and systematic analysis of entities, products and activities of the securities markets that could be the source of systemic risk); (iii) whether such arrangements allow for a periodic reassessment; and (iv) whether regulatory actions follow such assessments. These criteria are then evaluated in the context of the mandate of the regulatory agency.</p> <p>Even though monitoring, mitigating and managing systemic risk is not a responsibility explicitly included in ASIC's legislative mandate, it has set up processes to that effect, most notably by establishing the ERC. While it is still work in progress, the ERC follows a systematic approach to assessing emerging risks, including those with potential systemic impact. Its focus is on analyzing products and activities, given that the potential systemic risks arising from entities that fall under the sole responsibility of ASIC tend to be more limited than the ones arising from entities supervised by APRA. However, entity level systemic risks are assessed through other mechanisms, including by the RBA and APRA, and through the CFR in whose work ASIC contributes. Due to their role in setting and monitoring capital requirements of Clearing Participants, the CSFL holders also play a key role in ensuring that systemic risks do not build up through the participants of the clearing system.</p> <p>The specific regulatory actions taken on the basis of the ERC work are still limited. ASIC is encouraged to continue to further develop the work of the ERC and to ensure that it remains focused on identifying emerging and/or systemic risks in securities markets. Due to the sharing of supervisory responsibilities on securities market participants, it is important to ensure that the potential risks arising from those entities</p>

	are appropriately channelled to the CFR.
Principle 7.	The Regulator should have or contribute to a process to review the perimeter of regulation regularly.
Description	<p>Reviewing the regulatory perimeter</p> <p>The ERC is the main vehicle for ASIC to identify and assess the sufficiency of its regulatory requirements and framework. The ERC utilizes a number of standing papers which are designed to gather evidence of changing circumstances for consideration by relevant ASIC staff and to assess the adequacy of existing regulation. These relate to economic and financial developments, trends in the complaints data and international regulatory developments and risks.</p> <p>A key objective of the ERC is to review unregulated products and activities, and to assess the issues and risks posed by innovation in the financial services industry. A standing agenda item for the ERC is a discussion of any key issues of emerging concern that the stakeholder teams have identified either within or outside of the current regulatory perimeter. Examples of issues relating to the regulatory perimeter discussed include the lack of transparency in structured products, risks from commodity futures markets, and monitoring of complex shadow banking groups.</p> <p>One function of the Regulatory Policy Group (see Principle 2) is to review past regulatory policy decisions, and take measures as appropriate when there is evidence of changing circumstances relevant to ASIC policy.</p> <p>Addressing issues identified</p> <p>ASIC has an internal law reform process which is managed by the Strategic Policy team. Where ASIC has concerns that there is a regulatory deficiency in the CA or any other act it administers, ASIC may consult with the Treasury and propose law reform, where appropriate. ASIC may also raise the issue with other relevant departments (such as the Office of the Attorney-General). It engages with Treasury every three months to monitor the progress of its law reform requests.</p> <p>In addition to seeking law reform, ASIC is also able to act to protect investors or overcome a regulatory issue by issuing class orders and/or providing regulatory guidance. Since class orders are legislative instruments that change the law, targeted AFSL holders are required to comply with the law as amended by the class order. A class order was recently used to introduce new financial requirements for responsible entities (REs) of MIS in November 2011 (CO 11/1140).</p>
Assessment	Fully Implemented
Comments	<p>Key Questions 1, 2 and 3 of the Methodology require regulators to have processes in place to evaluate the perimeter of regulation. The guidance provided by IOSCO for this Principle is limited, which makes the assessment of this Principle challenging. As IOSCO develops additional guidance, and practices mature, there will be additional critical input to judge in a more granular way the level of implementation of this Principle.</p> <p>The key issues that have been taken into consideration for purposes of evaluating questions 1, 2 and 3 of the methodology are whether (i) there are specific arrangements in place whose objective is the review of the perimeter of regulation; (ii) whether such arrangements allow for a holistic and systematic analysis of entities, products and activities of the securities markets that could be the source of risks to the regulatory objectives; (iii) whether such arrangements allow for periodic reassessment of risks; and (iv) whether actions follow such assessments.</p> <p>The recently established ERC has the potential of becoming an important vehicle for</p>

	ASIC to effectively address issues relating to the regulatory perimeter. At the same time, it is important to ensure that that ERC remains focused on issues that are of strategic importance for maintaining the systemic stability and appropriate regulation of Australian securities markets. ASIC could leverage on ERC's role as a forum to discuss both potential systemic risks and the regulatory perimeter by using it to address the regulation of wholesale funds in Australia (see Principle 24).
Principle 8.	The Regulator should seek to ensure that conflicts of interest and misalignment of incentives are avoided, eliminated, disclosed or otherwise managed.
Description	<p>Regulated entities</p> <p>AFSL holders must have in place adequate arrangements for the management of conflicts of interest that may arise wholly, or partially, in relation to activities undertaken by the licensee or a representative of the licensee in the provision of financial services (s912A(aa) CA). As AFSL holders, this requirement applies to market intermediaries, REs of MIS (including hedge funds), CRAs and research report providers. There are also conflict of interest requirements for auditors (see Principle 20) and market operators (see Principle 9).</p> <p>ASIC aims at identifying conflicts of interest through its risk-based approach to surveillance. It requires disclosures about conflicts of interest to be timely, prominent, specific and meaningful to the client; occur before or when the financial service is provided, but in any case at a time that allows the client a reasonable time to assess its effect; and refer to the specific service to which the conflict relates.</p> <p>An example of where ASIC has taken additional measures to address the potential conflicts of interest is its November 2011 proposal to require research report providers to separate their research business and ancillary business units (such as consulting and fund management services) through physical and electronic separation (CP 171). This consultation paper also proposed that research houses need to lodge every two years a compliance report addressing, among other issues, internal conflicts management procedures and conflicts disclosure. ASIC is currently reviewing the submissions to the consultation that closed on 3 February 2012.</p> <p>Issuers</p> <p>CP 171 also addressed the question on whether research report providers should accept payments from product issuers to produce research about the issuers' products. The consultation paper sought feedback on whether these conflicts of interest could be effectively and robustly managed or whether they should be entirely avoided.</p> <p>The ABS market in Australia is a wholesale market and, as ASIC has no powers in relation to disclosure to wholesale investors, it has no power to mandate disclosure requirements for ABS. It has raised this issue with Treasury both in the context of ABS (specifically RMBS, which is the predominant asset class in Australia) and also with respect to covered bonds.</p> <p>In the case of both disclosure requirements and retention requirements ASIC has been working with the Australian Securitisation Forum (ASF) to encourage them to develop such requirements. The ASF has released disclosure standards in respect of RMBS which became effective from July 1, 2012.</p> <p>ASF is also in the process of developing disclosure standards for other ABS, indicating that it intends to be consistent to the extent practicable with international standards with respect to retention requirements. With respect to conduct obligations for ABS, there are no guidelines other than what is required under the Corporations Act of AFSL holders. These have been determined to date by generally accepted market practice.</p>
Assessment	Fully Implemented

Comments	<p>In connection with regulated entities, requirements for the management of conflicts of interest are imbedded throughout the IOSCO Principles, including the Principles for SROs, auditors, CRAs, sell-side analysts, CIS, and market intermediaries. Given the limited guidance by IOSCO, this assessment has focused on evaluating whether such requirements are in place and whether through its ordinary supervisory program the regulator seeks to ensure that they are met.</p> <p>As such, requirements for the management of conflicts of interest are a key part of the regulatory framework for all regulated entities under ASIC's supervision. They are also one of the main focuses of ASIC when it implements its risk-based surveillance program. ASIC has also aimed at addressing potential misaligned incentives for issuers through developing draft regulatory guidance and dialogue with industry bodies.</p> <p>Further developments are underway through the Australian Government's initiative to reform the provision of financial advice (Future of Financial Advice). The reforms are designed to reduce the occurrence of conflicts of interest and misaligned incentives, and include a prospective ban on conflicted remuneration structures in relation to the distribution and advice of retail investment products and a ban on soft-dollar benefits higher than A\$300 (per benefit) received by financial planning firms, their representatives and associates. These proposals were passed by the Parliament in June 2012. Compliance with these requirements is mandatory from 1 July 2013 and voluntary from 1 July 2012.</p>
Principles for Self-Regulation	
Principle 9.	Where the regulatory system makes use of Self-Regulatory Organizations (SROs) that exercise some direct oversight responsibility for their respective areas of competence, such SROs should be subject to the oversight of the Regulator and should observe standards of fairness and confidentiality when exercising powers and delegated responsibilities.
Description	<p>No organizations have formal SRO status in Australia and therefore none have powers formally delegated to them by ASIC. However, 17 AML and 5 CSFL holders perform certain functions which could be regarded as self-regulatory in respect of markets and clearing and settlement facilities. They have statutory obligations to regulate the participants that use their markets or facilities, monitor their behavior and have the power to impose meaningful sanctions on them. They also have statutory obligations to cooperate fully with ASIC. In practice only three AML holders are of any significance in terms of listing of securities and levels of activity on their markets: ASX, Chi-X and NSX. The last is considerably smaller than ASX in terms of listing and conducts considerably less trading than ASX and Chi-X. ASX holds four of the five CFSLs. This Principle is therefore assessed in that context. The role of the AML and CSFL holders and their responsibilities as regards their members and towards ASIC are discussed substantively in Principles 33 and 34.</p> <p>Eligibility criteria</p> <p>In order to participate, a person must meet the rules of eligibility established by the AML holder that operates the relevant market or the CSFL holder that operates the relevant facility. These rules prescribe such matters as:</p> <ul style="list-style-type: none"> • requirements relating to directors and/or supervisory structure; • business integrity requirements; • organisational competency requirements; • technical and/or human resource requirements; • capital/financial resource requirements; • insurance requirements; and • (in the case of CSFL holders) requirements to enter into clearing and settlement

agreements.

There are no explicit obligations under the law for the eligibility and other operating rules to be applied to current or prospective users/members in a fair and consistent manner. However an AML or CSFL holder has statutory obligations to the extent reasonably practicable to do all things necessary to ensure that the market is fair, orderly and transparent and that its services are provided in a fair and effective way. The dominant exchange, ASX, has an Appeals Tribunal for entities refused admission as a participant to any of its clearing and settlement systems. An applicant for admission as a trading participant to either of its licensed markets, ASX (equities) and ASX 24 (futures) cannot appeal that decision. However, ASX interprets its statutory requirement to operate a fair market as unambiguously extending to admission decisions. The courts provide the ultimate route of appeal. Depending on the business model of the applicant the ACCC may also have a role to play.

AML and CSFL holders must have adequate arrangements for monitoring and enforcing compliance with their operating rules, including the binding rules of trading for participants. A licensed market's operating rules must also deal with ongoing requirements for the conduct of participants and execution of orders. License holders must also have a set of operating rules that provides for the expulsion, suspension or disciplining of a participant.

When an entity submits a draft application for an AML or CSFL to ASIC, the application must include draft operating rules which ASIC reviews to ensure they cover the required content and are consistent with the CA and, where appropriate, the Market Integrity Rules (MIR). As discussed in Principle 33 the decision on whether to accept or reject a rule change resides with the Minister on advice from ASIC. ASIC often works extensively with the applicant to ensure their operating rules and procedures are appropriate and will interface with the applicant before reaching the point of inviting a formal application. That process can sometimes be time consuming.

ASIC must be notified in writing of any changes that are made to the operating rules of an AML or CSFL. If the license holder fails to notify ASIC within 21 days the changes will cease to have effect. ASIC will consider the effect of the operating rule change on the AML or CSFL holder's obligations and provide advice to the Minister, who then has the power to disallow all or a part of the change to the operating rules (within 28 days). ASIC's process of reviewing a proposed rule change involves consideration of the wider effects of the change in light of current ASIC policy. Generally, a comparison is conducted of similar rules for other comparable markets – domestically and internationally as applicable, to ensure that the proposed change is not inconsistent with best practice and/or current legislation and policy. In the case of a CSFL, an important element of the Minister's decision will be whether the rule change complies with the RBA Financial Stability Standards (FSS).

As regards the separation of an exchange's commercial and regulatory function, ASIC's regulatory guidance to AML holders requires it to consider whether an AML holder's organizational and reporting structures separate its commercial activities from its supervisory activities to a significant degree (RG 172.87). ASIC has set out what acceptable organizational practices to achieve this end are. In the case of ASX the exchange has established ASX Compliance Pty Ltd as a wholly owned subsidiary within the ASX Group that provides compliance and enforcement services to the various ASX Group entities that operate markets or CS facilities. ASX Compliance has been delegated authority to make certain compliance and enforcement decisions on behalf of the relevant ASX licensee under its Operating Rules. It is divided into three functional units: Listings, Participants and the Executive Office. The Listings unit is responsible for processing listing applications and enforcing compliance with the listing rules. The Participant unit is responsible for processing applications for admission as a Market or Clearing and Settlement participant, and enforcing compliance with the

Operating Rules. The Executive Office is responsible for bringing disciplinary action against participants for breaches of ASX's Operating Rules.

The law contains several obligations on AML and CSFL holders to cooperate with ASIC. AML holders must notify ASIC of certain matters, including but not limited to breach of their own AML obligations, all disciplinary action taken against a participant and any suspected breaches of the operating rules or the CA. The CA provides protection to AML holders and CSFL holders from defamation actions in respect of information that each may circulate in the performance of their respective duties. ASIC has MOUs in place with three AML and CSFL holders (namely ASX, Chi-X, and NSX). These MOUs set out the general arrangements between ASIC and the relevant AML/CSFL holder for cooperation and assistance in relation to monitoring and, where appropriate, enforcing provisions of the CA, the operating rules and the listing rules in relation to each market. In addition, following ASIC's assumption of responsibility for market supervision in August 2010, ASIC entered into protocols for the sharing of information with ASX and Chi-X in relation to the MIRs. These protocols set out processes for cooperation and the sharing of information between ASIC and the licensee to facilitate the supervision of the market and participants under the MIRs.

An AML or CSFL holder's operating rules operate as a contract between the AML or CSFL holder and the market participants ("member" is the more traditional term). AML holders must have adequate arrangements for monitoring and enforcing compliance with the market's operating rules and CSFL holders must have adequate arrangements for enforcing compliance with the facility's operating rules. As a "for profit" body corporate an AML or CSFL holder is not obliged to appoint users/members to its board.

Oversight by ASIC

ASIC conducts annual assessments of how well an AML or CSFL holder is complying with its obligations as a licensee, but may also make an ad hoc request at any time in the course of discharging its obligations under the CA. ASIC will ordinarily request access to the market or facility and to books or other information as part of its annual assessments of these licensees. As part of the annual assessment ASIC will visit the offices of the AML or CSFL holder to interview staff about the policies, procedures, processes, and arrangements it has in place to ensure compliance with its obligations under the CA. The assessments are published. The assessments are both historical and forward looking and make recommendations for action that are followed up during the year and at the subsequent assessment.

An AML or CSFL holder is subject to the obligation to notify ASIC if it becomes aware that it may no longer be able to meet, or has breached, an obligation. License holders are subject to a broad range of additional reporting obligations including (for an AML holder) notifying ASIC, other market operators and participants immediately upon becoming aware of a technical problem affecting its trading, compliance monitoring and reporting systems and (for a CSFL holder) notifying the RBA of when it becomes aware that it has failed to comply with the FSS. In addition, each AML and CSFL holder is obliged to give ASIC an annual report and any required audit report on the extent to which it has complied with its obligations as a licensee. ASIC must give the report to the Minister. The Minister may also require the AML or CSFL holder to give to ASIC a special report on specified matters and include an audit report if necessary. ASIC must give this report to the Minister.

There is no delegation of ASIC's authority to inquire into matters concerning investors or markets, and these powers are not superseded by the functions of the AML or CSFL holder. ASIC therefore has full authority to inquire into matters affecting investors or the market, to require that AML and CSFL holders give it such assistance as it deems necessary, and to take such action as it deems necessary in the public interest, to protect people dealing in a financial product or class of financial products. Furthermore, the fact that AML and CSFL holders perform certain self-regulatory functions does not

	<p>detract from ASIC's powers for inquiring into or addressing misconduct or allegations of misconduct. For example, ASIC has independent powers to investigate breaches of a licensed market's continuous disclosure requirements and enforce the law. Where the powers of an AML or CSFL holder are inadequate, ASIC can intervene. ASIC has specific powers that may be exercised concurrently with the relevant AML/CFSL holder.</p> <p>ASIC has the function of supervising financial markets, the operators of which hold AMLs. This function includes the making of, ensuring compliance with, and enforcing of MIRs applicable to the particular market. ASIC based MIRs for particular markets on the existing operating rules of that market. ASIC may become aware of information that may assist an AML holder in complying with its responsibilities in respect of its market operating rules. Conversely, the AML holder may become aware of information that will be relevant to ASIC in assessing the AML holder's compliance with the CA, including but not limited to assessing its compliance with the MIRs for its market.</p> <p>AML and CSFL holders are held to the same professional standards as ASIC. These include matters such as confidentiality, information handling, procedural fairness and conflicts of interest. Two items are of note. Where the AML holder or a related entity is listed on its own market the market's listing rules must provide for ASIC, instead of the AML holder, to make decisions and take action in relation to the license holder's admission to or removal from the official list and allowing, halting or suspending trading on the market of its financial products. There must be a separation between the supervisory functions, such as disciplinary action and monitoring of the market, and the commercial functions, such as the listing committee and business development strategies. The degree of that separation varies depending on the nature, size and structure of the market.</p> <p>Either as a result of ASIC's oversight or from other information, the Minister may come to believe that the AML or CSFL holder has breached one or more of its obligations. In that case, the Minister may give notice to the license holder that requires it to show cause at a hearing why the license should not be suspended or cancelled. An ASIC officer or someone else may conduct the hearing; they must report to the Minister with a recommendation. Based on this hearing, a recommendation can be made to the Minister to suspend or cancel the license. The Minister has the power to suspend or cancel the license after having considered the report and recommendation.</p> <p>As a consequence of ASIC's assumption of responsibility for market supervision in August 2010, the AML holders are now responsible for enforcing a smaller suite of trading rules with which their members must comply than was the case previously. These are essentially the rules and procedures around order handling and the members' obligations to contribute to the operation of an orderly market. Previously the AML holders were also responsible for enforcing the more significant rules concerning the prohibitions on market manipulation, insider trading, front running etc. The AML holders also gave up responsibility for monitoring and enforcing regulatory capital rules on their non-clearing (or trading-only) members which is now carried out by ASIC. ASX, as the operator of four of the five clearing and settlement facilities is still responsible for enforcing the regulatory capital requirements of its clearing members. ASX and the other 'listing markets' have also retained responsibility for their Listing Rules which includes enforcing the continuous disclosure regime to which listed companies are subject.</p>
Assessment	Fully Implemented
Comments	
Principles for the Enforcement of Securities Regulation	
Principle 10.	The regulator should have comprehensive inspection, investigation and surveillance powers.
Description	ASIC has a comprehensive range of inspection, investigation and surveillance powers

supported by a wide range of sanctions for non-compliance by any person (natural or legal), including a bank. Because the definition of a financial product in the CA is extremely broad, all banks hold both an ADI and an AFSL. ASIC has the power to inspect, on- and off-site, on a routine basis and in relation to a particular inquiry, books that an entity keeps as required by the CA without prior notice (although ASIC's practice is to give prior notice unless there is reason not to). 'Books' is widely defined. It is a strict liability offence if a person fails to provide access to its books. This power extends to all corporations, not just regulated entities, and is a very broad power. ASIC also has the power to require the production of books by serving a notice to produce; this may be served without prior warning and production can be required forthwith.

ASIC will generally apply for a search warrant if there is concern that the books might be destroyed if notice is given. Search warrants are issued by a magistrate to a member of the Australian Federal Police (AFP) on the application of ASIC. In relation to a suspected criminal offence, ASIC may also obtain, and the AFP may execute on behalf of ASIC, a search warrant pursuant to the Crimes Act. ASIC may seize evidential material by way of a search warrant issued by a magistrate under the Proceeds of Crimes Act. ASIC also has powers to enter premises and/or apply for search warrants under the Insurance Act if the ASIC staff member is authorized by APRA to do so (such approval has never been refused), the Life Insurance Act, the Retirement Savings Account Act and the Superannuation Industry (Supervision) Act. Where a company is being wound up or a provisional liquidator is acting, the court may issue a warrant to search for and seize the company's property or books on the application of ASIC if the court is satisfied that a person has concealed, destroyed, or removed books of the company or is about to do so.

Failure to comply

Where ASIC is satisfied that a person has, without reasonable excuse, failed to comply with a requirement to produce books or has not complied with a requirement made by ASIC, it may certify the failure to the court. If ASIC does so, the court may inquire into the case and may order the person to comply with the requirement. If the person does not comply with the order of the court, that person may be found guilty of contempt of court and punished accordingly (which may include a term of imprisonment or a fine). A person who fails to comply with a requirement intentionally or recklessly is potentially liable to punishment (including a term of imprisonment of up to two years).

Other surveillance powers

There are additional provisions in the ASIC Act and the CA that ASIC can rely on to inspect an entity's business operations. Sanctions can be applied to individuals for failure to comply. ASIC also has powers under the Insurance Act, Life Insurance Act, and Retirement Savings Account Act to obtain information. If a demand to inspect this information is not met, ASIC may obtain a search warrant under those Acts, as outlined above. In the exercise of these powers ASIC seeks to act responsibly and appropriately, to be accountable and transparent in its use of these powers, and to protect the confidentiality of the information it has gathered. To that end ASIC has published a policy on its information gathering powers which is available on its website, and has also developed internal guidance for staff using these powers in an Enforcement Manual.

ASIC's powers to demand the production of books are supported by extensive record keeping and record retention requirements for all companies, AFSL, AML and CSFL holders. The CA imposes an obligation on all AFSL holders to keep financial records. These must include moneys paid and received, financial products bought and sold, names of buyers or sellers, names of those who gave instructions to buy and sell, and names of owners of financial products held on their behalf by the AFSL. A record of each transaction must state whether the transaction was on behalf of a client, on the

	<p>AFSL holder's own account, or on behalf of an employee, as well as the day (or period of time) on which the transaction took place. Additional record keeping requirements apply where an AFSL holder deals through a stock or derivatives exchange for own or client account.</p> <p>An AFSL holder must deposit money paid by a client in connection with a financial service or product (excluding remuneration, reimbursement or loans) into a bank account maintained at an ADI. An AFSL holder is obliged to keep financial records that record and explain correctly the financial position of the financial services business carried on by the AFSL holder. Failure to comply with this obligation is an offence punishable by five years imprisonment or a fine of A\$22,000, or both. The records must also be kept in sufficient detail in respect of certain matters listed in the CA which also sets out requirements relating to the language and format of records, the place where the records must be kept, and the access required. Financial records are to be retained for seven years after the transactions covered by the record are completed; other records (including transactional records) are to be retained for five years. Records must be kept in the English language (or amenable to translation), and accessible in Australia. There is also a requirement that books be available for inspection at the registered office of the entity and be available for inspection by the public during its 'normal business hours'.</p> <p>Outsourcing by ASIC</p> <p>ASIC generally does not outsource its functions to a third party. AML and CSFL holders monitor conduct of their members on or in relation to their markets. Although this is not formally an "outsourcing agreement" it should be noted that, as discussed in Principle 9, ASIC has an effective ongoing oversight program of AML and CSFL holders, including the inspection of AML and CSFL holders, periodic reviews, reporting requirements, review of any changes to the operating rules, and the monitoring of continuing compliance with the conditions of the license. ASIC also has the power to require changes and improvements to systems, controls and surveillance processes.</p>
Assessment	Fully implemented
Comments	<p>There appears to be a large degree of redundancy in the record keeping requirements that apply to AFSL holders which deal for clients. When dealing on Australian securities and derivatives exchanges some requirements seem to be triplicated. The "customer due diligence" AML requirements add a further layer of regulation.</p> <p>In 2010 the ASIC Act was amended so that ASIC may now, for the purposes of any investigation (whether criminal or civil), either issue a notice for the production of documents or apply for a search warrant under the ASIC Act without first having to issue a notice to produce the material. Previously, a warrant could only be issued under the ASIC Act if there were grounds to suspect that a notice to produce documents had not been complied with.</p> <p>The extent to which ASIC's powers are used proactively and reactively and the effectiveness of their use is assessed under the sectoral Principles covering collective investment schemes and hedge funds, credit rating agencies (CRA), market intermediaries and secondary markets.</p>
Principle 11.	The regulator should have comprehensive enforcement powers.
Description	<p>ASIC has a broad suite of investigative and enforcement powers to enforce compliance with the laws and regulations relating to securities activities under the CA supported by a broad range of sanctions from modest to severe. ASIC has a general power to commence investigations which it considers expedient for the administration of the CA. This power can be exercised in circumstances where ASIC has reason to suspect that there may have been a breach of the CA or a law of the Commonwealth or a State or Territory that concerns the management or affairs of a body corporate or managed</p>

investment scheme or involves fraud or dishonesty and relates to a body corporate, a managed investment scheme or another financial product.

Some of ASIC's powers may only be used where a formal investigation has been commenced. The principal investigative power which may only be used in this context is the power to compulsorily examine a person on oath. This includes regulated and non-regulated persons. The examinee is not excused from answering a question on the grounds that it may incriminate the person or make the person liable to a penalty, but where the examinee claims that this is the case, the answer provided is not admissible against him or her in other criminal proceedings. Other powers (such as the inspection powers) may be used both for the purposes of an investigation or for the performance or exercise of any of ASIC's functions or powers.

Sanctioning powers include:

- obtaining enforceable undertakings;
- various administrative powers and sanctions;
- seeking civil penalties from the courts; and
- commencing criminal prosecutions, although these are generally conducted by the Commonwealth Director of Public Prosecutions (CDPP).

Enforceable undertaking

An enforceable undertaking is an administrative settlement ASIC may accept as an alternative to court action or certain other administrative sanctions. It is offered by the person and may be accepted by ASIC. It does not consist of a commitment never to repeat the breach but it must specify how the officer will address the conduct ASIC is concerned about. In the case of a body corporate the offer is generally to institute improved compliance and control systems which seek to ensure that the breach does not recur. Usually this process is overseen by an independent expert. ASIC must also be satisfied that the entity has adequate arrangements for monitoring how the enforceable undertaking is implemented and reporting to ASIC. In the case of an individual the enforceable undertaking may be to exit the financial services business and not return. An enforceable undertaking cannot be used as a substitute for a criminal sanction. Often the terms of an enforceable undertaking will require the entity to put in place an appropriate mechanism to notify clients of potential detriment and then assess any complaints received. This could lead to payment of compensation. Again, this process is often overseen by an independent expert. The terms of the enforceable undertakings often allow for the compensatory element to be further addressed in consultation with ASIC.

Administrative sanctions and civil action

ASIC's powers are supported by an extensive and graduated range of administrative sanctions which ASIC can impose depending on its view of the nature and severity of the offence. They can be calibrated to achieve the objectives of being effective, proportionate and dissuasive. They include:

- banning a person from providing financial services;
- immediately suspending or cancelling an AFSL;
- suspending or cancelling an AFSL after offering a hearing;
- issuing an infringement notice (with a financial penalty) as an alternative to civil monetary pecuniary penalty proceedings;
- issuing a stop order (for example if a PDS or prospectus is defective);
- giving a direction to an AML or CSFL holder (including to suspend dealings in a financial product or class of financial products);
- imposing, varying or revoking conditions on an AFSL;

- issuing a public warning notice about a person; and
- obtaining a court order to enforce compliance with an enforceable undertaking.

However ASIC cannot directly impose monetary penalties. An infringement notice issued by ASIC may require that a penalty be paid, but the notice is not enforceable as such. If someone refuses to pay the penalty, ASIC can commence civil penalty proceedings.

Where ASIC believes that it is necessary, or in the public interest, to protect people dealing in a financial product or class of products traded on a financial market, ASIC can give a direction to an AML holder to suspend dealings in that financial product or class of financial products. There are no instances where ASIC has found it necessary to formally exercise this power as such instances have always been resolved by agreement. ASIC may also direct a person to give full details of their interest in shares or a scheme and information identifying other persons with a relevant interest in any of the shares or interests. It is an offence to fail to comply with such a requirement. ASIC may also make an application for shares to be vested in ASIC and for the sale of those shares in the event that a recipient of a notice under the CA states that they do not have information about the securities or the holder of relevant interests in them.

In terms of other remedies, ASIC may apply to a court for an order compelling compliance with ASIC's regulatory and investigatory powers. Failure to comply that is intentional or reckless is an offence punishable by a fine of A\$11,000 or two years imprisonment, or both. There are also offence provisions relating to the provision of false or misleading information to ASIC in purported compliance with investigative powers under the ASIC Act, obstruction or contempt of ASIC, and the concealment of books. ASIC also has powers to make orders restraining a person from dealing with specified securities (disposal, acquisition, and voting), orders preventing the issue of shares to a person, and orders preventing the registration of the transfer of securities.

ASIC may commence a broad range of civil proceedings including, but not limited to, seeking:

- the winding up of a corporation;
- compensation orders;
- statutory injunctions and related orders;
- asset freezing, receivership and related remedies;
- restitution orders; and
- orders restraining a person from carrying on a financial services business.

Civil penalty orders that may be sought include a

- declaration that the defendant has breached the CA;
- financial penalty order;
- disqualification order; and
- compensation order.

Initiation of criminal proceedings

Where conduct constitutes a breach of criminal law ASIC has the power to commence criminal proceedings in relation to offences under the CA. In practice, ASIC only undertakes minor summary prosecutions, and refers other matters to the CDPP for prosecution. Where ASIC has concluded following an investigation that a criminal prosecution is more appropriate to deal with a particular matter, ASIC refers a brief of evidence to the CDPP. ASIC conducts regular liaison meetings with the CDPP at both a state and national level, and all matters referred to the CDPP for prosecution are regularly reviewed at these meetings. ASIC may also refer a matter to a State DPP, where ASIC's investigation discloses that offences under State law have been

	<p>committed and the matter is most appropriately pursued by that agency (for example, fraud is a State offence). However, such referrals are rare as the CDDP can, in most instances, also prosecute State offences.</p> <p>Private right of action</p> <p>Enforcement or corrective action taken by ASIC does not compromise private rights of action to seek remedies for misconduct relating to the CA and ASIC Act. These rights are extensive, notably as regards action against company directors for breach of their obligations to the company or to shareholders. Class actions are permissible in Australia and can be run on a contingency fee basis.</p> <p>Where another authority must take enforcement or other corrective action ASIC may share information, which it has obtained in the course of carrying out its functions or exercising its powers to assist that authority. Issues concerning confidentiality, ASIC's ability to share information with other domestic and foreign authorities and its entering into MoUs with other domestic and international regulatory authorities that provide for information sharing arrangements are described in Principles 13 and 15. Conversely, depending on the type of information sought by ASIC, there are other authorities in Australia that can obtain information which may be necessary to an investigation conducted by ASIC. Other domestic authorities in Australia may generally share information in their possession with ASIC for its use in investigations and proceedings.</p>
Assessment	Fully Implemented
Comments	<p>ASIC's enforcement powers are generally of long standing and well understood by licensees and the public. As discussed in Principle 12 ASIC has no reluctance to use its powers to enforce compliance. It has a well constructed process for filtering potential cases, for determining which cases to pursue through enforcement mechanism and which by other means, and how to employ resources in the most efficient and effective way.</p> <p>An enforceable undertaking is a uniquely Australian form of remedy, although there are similarities with settlement procedures elsewhere in that the undertakings are made public, the offeror is not permitted to criticize the terms of the undertaking, the measures necessary to meet the terms are often complex and expensive and ASIC's views on the breach are made clear which should inform and improve corporate and individual behavior generally. Although it suffers, as do all such settlement processes, from the deficiency that the alleged breach of the law is not tested in court and therefore lacks a degree of legal certainty, there appears to be a general consensus among licensees and the public that enforceable undertakings are a useful means of modifying behavior of those subject to an enforceable undertaking and those whose conduct might in due course cause them to behave in a way which ASIC has made clear it finds unacceptable.</p>
Principle 12.	The regulatory system should ensure an effective and credible use of inspection, investigation, surveillance and enforcement powers and implementation of an effective compliance program.
Description	<p>When considering Principle 12 (and Principles 16-18) it should be kept in mind that the scope of ASIC's responsibilities is very broad in comparison with most securities regulators. It has recently taken on responsibility for consumer credit providers; it is the public oversight body for the auditing profession and carries out the functions that in other jurisdictions are generally carried out by a separate office of the companies registrar. ASIC is therefore responsible for ensuring that 1.8 million companies comply with their obligations under the CA. ASIC's assessable functions under the IOSCO Principles are in relation to a sub-set, some 2000 stock exchange listed companies and others with a legal requirement to disclose certain information about their affairs periodically and on a continuous basis.</p>

	<p>The enforcement function is performed by eight Deterrence teams based in each State and Territory, covering three market sectors and containing a total of 256 people at present. The Market Integrity and Corporate Governance Deterrence team has two functions:</p> <ul style="list-style-type: none"> • investigating and prosecuting alleged insider trading, market manipulation, continuous disclosure, making of false and/or misleading statements, contraventions of market integrity rules; and • investigating misconduct by company officers, advisers, liquidators and auditors. <p>The Financial Services Deterrence team investigates misconduct within the financial services sector, including credit.</p> <p>Both teams are empowered to take enforcement action to achieve criminal convictions, civil penalties or administrative sanctions.</p> <p>ASIC's Deterrence teams take action based on a number of factors, including the strategic significance of a matter (extent of harm or loss), alternative courses of action available to an investigation, cost versus regulatory benefit, and the availability of evidence. If the referral is accepted, Deterrence formally investigates the suspected misconduct.</p> <p>Where the investigation is into market misconduct, assistance is often sought from the Market and Participant Supervision team (MPS) analysts in obtaining further information and providing technical analysis. The time taken to identify matters, report them as suspicious and refer to Deterrence for investigation is generally less than it was before ASIC took over market supervision. Analysts in the MPS team are encouraged to engage with relevant Deterrence staff early in their examination of potential market misconduct, prior to formal referrals.</p> <p>Inspection powers</p> <p>ASIC carries out periodic on-site inspections on a limited basis and relies largely on risk based surveillance. However, in ASIC's view current levels of periodic assessment may not be sufficient in some areas and- risk based surveillance requires further harmonization across sectors and greater granularity.</p> <p>For market participants which are AFSL holders and members of securities and derivatives exchanges, MPS makes regular surveillance visits to Market Participants based on a risk assessment process named RADAR. See Principle 31 for further details.</p> <p>The Exchange Market Operators team (EMO) undertakes annual compliance assessments of all licensed markets and clearing and settlement facilities involving on-site visits and interviews, as well as desk reviews. Of the 28 staff in EMO 3.5 are allocated to conducting annual assessments.</p> <p>For audit firms, the Financial Reporting and Audit team (FRA) conducts periodic reviews of the 'Big 4' audit firms (which audit about 95percent of the listed company population by market capitalization and 53percent by number) on an 18-month cycle. Other firms are reviewed on a longer cycle. The program aims to cover the entire population (numbering 2,216) over five years, although some higher risk entities are reviewed more frequently. Audit firm inspections are conducted on-site at firm locations around Australia. Auditor oversight is conducted by 11 staff members who are all qualified and experienced auditors. The team also works on listed entities and unlisted entities that have a large number of financial report users and a potentially greater market impact due to any non-compliance with financial reporting and auditing requirements. The targeting criteria vary from period to period, having regard to assessed risks. Financial reporting surveillances are primarily desk-based (with some on-site visits where necessary).</p>
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COR's team of 58 focuses on transactions undertaken in relation to public companies that raise significant risks for investors and market confidence. 5.5 employees are involved in surveillance work and a further 20 are involved in document reviews. The team reviews a high proportion of fundraising and (currently) all control transactions where documentation (e.g., prospectuses) is required under the CA to be lodged with ASIC. It undertakes ongoing risk-based surveillance on issues identified as emerging risks for investors and market confidence. Risk-based surveillance is primarily desk-based.

By the end of May 2012, IB's team of 25 had undertaken five proactive risk-based surveillance projects focusing on areas of potential or emerging risk. Four of those were aimed at each of its four regulated populations (investment banks, hedge funds, retail derivative issuers and CRAs) and one was aimed at the surveillance of retail structured products and retail hedge fund PDSs. Surveillance activities are a mixture of desk-based analysis and on-site inspections.

Surveillance by Consumers, Advisors and Retail Investors (CARI) and Investment Managers and Superannuation (IMS) stakeholder teams are discussed under Principles 31 and 24 respectively.

Securities and derivatives market surveillance

Market surveillance is carried out by the Market Surveillance Team in MPS. Its 25 staff undertake market surveillance of all domestic licensed markets and post-trade analysis to detect market misconduct including insider trading, market manipulation and breaches of the MIR. It also looks for possible misleading or deceptive statements in announcements that have been released to the market or potential continuous disclosure breaches. In such instances, the team also liaises with the ASX Issuers department.

The team uses the SMARTS automated trade surveillance system for the ASX and Chi-X markets (which is used by many exchanges and market regulators worldwide), third party information vending systems (such as Bloomberg and IRESS), access to ASIC company databases, and surveillance tools developed internally to detect price and volume anomalies. These monitoring tools, and the uses to which they are put, are described in more detail in Principle 34.

When ASIC assumed responsibility for supervision of domestic markets in 2010, it brought across a number of experienced surveillance analysts from ASX whose extensive trade surveillance experience combined with automated surveillance tools allows for successful identification of possible serious market misconduct. ASIC has also recruited market professionals with experience in automated trading, proprietary trading and derivatives.

Alerts of unusual trading activity generated by SMARTS are reviewed by analysts, in the first instance as to whether there is an explanation for the alert by reference to available market information, including media, internet chat sites, broker research, and dialogue with brokers. The number of alerts can be affected by a range of factors, including general market volatility, the level of corporate transactions, and trading conditions generally. Where market surveillance analysts are not able to explain an alert or a series of alerts, preliminary enquiries are conducted through the use of ASIC's compulsory powers to make formal enquiries of market operators, participants, clients, listed entities, and corporate and other advisers.

Matters dealt with in the MPS team are overseen by a Case Management Committee, which meets weekly to prioritize cases according to a four category scale of seriousness including whether a case should be referred straight to Deterrence for further investigation and whether Deterrence should escalate it to the Markets Disciplinary Panel or take appropriate action under the CA. A Triage Committee aims to

ensure national consistency of approach in market matters. The Triage Committee is made up of senior staff from the MPS and Deterrence teams.

Breach reporting and reports of misconduct

To deal with intelligence received from various sources, including public inquiries, complaints, statutory reports and breach notifications ASIC established the Misconduct and Breach Reporting (MBR) team to assess each piece of intelligence to determine whether further action is recommended and whether a matter should be referred to a specific stakeholder or deterrence team. MBR employs 95 people of whom around 75 work on non-credit matters.

Resolution of cases at the MBR stage can take a variety of forms including achieving compliance by the licensee or other person; referral to internal or external dispute resolution; assistance provided to resolve complaint when within jurisdiction; warning letter or consumer alert issued; referral to a more appropriate government agency within the jurisdiction.

Breach reporting

There is an obligation on AFSL holders to notify ASIC as soon as practicable (and in any event within ten business days) that they have breached or are likely to breach their AFSL obligations in a significant way. The table below shows the trend in the number of finalized breach reports (excluding insurance matters) since 2006-07.

Finalized Breach Reports (excluding insurance matters) Since 2006-07

	2006- 2007	2007- 2008	2008- 2009	2009- 2010	2010- 2011
Total number of breach reports	1364	1180	1187	1466	1217
Analysis of the origin of breach reports since		2009/2010		2010/2011	
AFS Licensee's Auditor's Report of Adverse matters		166		179	
AFS Licensee's Breach Report		628		628	
Compliance Plan Auditor's Report of Adverse matters		85		45	
Breach Report by Responsible Entity		249		72	
Auditor's Breach		338		293	
Total number of breach reports		1466		1217	

Source: ASIC

Taking 2010-11 as an example, of the 1217 breach reports received, MBR determined to take no action in 528 (43percent) instances although all reports are analyzed, assessed and recorded. A further 338 (27percent) were merged with existing matters. This is assisted by ASIC's integrated data base which enables matters arising concerning a person or a body corporate to be cross checked with any other matters previously recorded elsewhere in ASIC (such as in a license application or an enforcement case). The remaining 377 (30percent) were referred to the relevant team for follow up or merging with existing investigations. In a few cases the referral was directly to the Deterrence (enforcement) team.

Reports of misconduct

ASIC provides an external online system for the submission of reports of misconduct by members of the public, company officers, industry participants, advisers, interest groups or any other person who becomes aware of potential misconduct. Reports are

also accepted in written hard copy form. Unsolicited reports are also received from other law enforcement agencies or from the regulated population under statutory obligations. All reports of misconduct received by ASIC are referred to the MBR team. ASIC aims to respond to those reporting misconduct within 28 days of receiving their report; however this process may take longer if ASIC determines it is necessary to exercise compulsory powers to collect evidence, or the matter is complex.

ASIC formally assesses every report against nationally-consistent risk-based selection criteria to determine whether it raises an issue requiring a regulatory response. Some reported misconduct is referred to other areas within ASIC for further surveillance or enforcement action. Such referrals are made with reference to risk-based selection criteria, known priorities and risk areas identified by the stakeholder teams within ASIC (such as fraud or gross negligence). Where it would be inappropriate to take significant regulatory action, other action may be pursued to resolve the consumer's concern or, if the opportunity exists, for ASIC to ensure that the instance of non-compliance is amended quickly. Applying these processes, in 2010-11 ASIC managed 15,634 public reports of misconduct (17 percent increase from 2009-10). 78 percent of the assessments of these reports were finalized in 28 days, with 28 percent of the reports of misconduct escalated within ASIC for compliance, investigation or surveillance (compared to 21 percent in 2009-10).

Supervisory and compliance system requirements of AFSL holders

The CA (and ASIC) require AFSL holders to have in place supervisory and compliance systems that are reasonably designed to prevent securities laws violations. These include:

- Having in place adequate arrangements for the management of conflicts of interest;
- Taking reasonable steps to ensure that their representatives comply with the financial services laws;
- Ensuring that their representatives are adequately trained and competent to provide financial services; and
- Having a complaint dispute resolution system (if the financial services are provided to persons as retail clients).

ASIC policy also requires AFSL holders to have appropriate compliance measures, processes and procedures in place to meet these obligations, which are suitable to the nature, scale and complexity of their businesses. ASIC expects that oversight of these compliance measures is to be allocated to a senior, experienced officer of the AFSL holder, and the compliance area to be sufficiently independent, adequately staffed and resourced and have access to relevant records. Furthermore, in assessing an AML holder's compliance with its supervisory obligations, ASIC considers how it:

- Handles conflicts of interest;
- Monitors the conduct of participants;
- Monitors trading and other market activity and disclosure by listed entities, to detect potential or actual non-compliance with the law or the market's operating rules;
- Deals with actual or suspected breaches of the law or the market's operating rules, including remedial, disciplinary and other deterrent measures;
- Deals with complaints about the market or participants;
- Shares supervisory responsibilities and information with ASIC and operators of other markets and clearing and settlement facilities that have the same participants as the market licensee; and
- Makes available and uses resources for conducting supervisory activities

Prioritization in the enforcement area

ASIC's approach to the exercise of its enforcement function has several key elements intended to address the issue of effectiveness. ASIC carefully considers how to

respond to all potential breaches of the law, but does not undertake a formal investigation of every matter that comes to its attention. ASIC considers a range of factors when deciding whether to investigate and possibly take enforcement action, to ensure that it directs its finite resources appropriately. The specific factors ASIC considers will vary according to the circumstances of the case. ASIC's priorities will necessarily evolve and change over time and that influences the focus of enforcement. Broadly, however, ASIC considers the following four issues in deciding to take enforcement action:

- Strategic significance;
- Regulatory benefits of pursuing misconduct;
- Issues specific to the case; and
- Whether there are alternatives to formal investigation.

ASIC also considers the tools available to it and how it might choose to use them given that it has a wide range of enforcement actions it can take and sanctions that it can apply. ASIC views publicizing enforcement actions as a key element of an effective enforcement program in modifying behavior of regulated entities. ASIC always asserts its right to make an enforcement outcome public, unless the law requires otherwise. ASIC does not agree to keep enforcement outcomes secret. Along with communication of enforcement outcomes on the ASIC website ASIC's profile is also raised through the use of social media (Facebook, Twitter and You Tube) and its MoneySmart website (which has had over 1.2 million unique visitors since its launch in March 2011).

Resources dedicated to surveillance and enforcement activity

Deterrence teams work closely with the relevant stakeholder teams in the specific areas of financial services, market integrity and corporate governance. ASIC's Deterrence teams, with around 256 staff members nationally, have functions that include:

- Identifying and investigating inappropriate securities and credit activity conduct, based on the regulatory impact, extent and the nature of that conduct;
- Working with the CDPP to secure criminal enforcement outcomes;
- Taking civil action, restraining assets, winding up companies and acting for the protection of consumers and the investing public; and
- Undertaking administrative action and banning decisions and obtaining enforceable undertakings to protect the public from those who fail to act efficiently, honestly and fairly in the marketplace.

Summary of Results of Investigations Since 2007 (in millions of Australian dollars)

	2006/ 2007	2007/ 2008	2008/ 2009	2009/ 2010	2010/ 2011
Litigation Completed					
Total	479	280	186	156	202
Administrative	49	49	52	36	39
Civil	379	174	88	90	134
Criminal	51	57	46	30	29
Litigation Completed					
Successfully	97%	94%	90%	91%	90%
Criminals convicted	42	49	34	22	25
Criminals jailed	21	23	19	12	16
Summary prosecution:					

	officers prosecuted	561	752	724	554	425
	<hr/>					
	<u>Summary prosecution:</u>					
	finances and costs against company officers	A\$1.1	A\$1.07	A\$1.03	A\$.813	A\$.873
	Costs, fines and compensation	A\$102	A\$46	A\$14.5	A\$287	A\$95
	Assets frozen People/Companies banned	A\$38	A\$100	A\$13.8	A\$15.5	A\$17.6
	<hr/>					
	from financial services/credit Enforceable Undertakings	35	49	42	41	64
		10	11	14	8	14
	<hr/>					
	Source: ASIC					
	<p>Although the above statistics predominantly reflect ASIC's role as the regulator of the corporate sector, the figures for the number of persons and companies banned from the financial services and credit sectors include significant numbers of cases involving AFSL holders and their directors. For example, in 2010/11, 25 litigations involving AFSL holders were completed (18 administrative offences, six civil and one criminal), 86% of them successfully.</p>					
	<p>Effectiveness and credibility</p> <p>ASIC is an outcomes focused regulator. In discussions with senior enforcement and other staff they freely acknowledged the difficulty of measuring the effectiveness and credibility of the enforcement processes. A significant amount of senior management time is devoted to addressing this issue. They believe that their intelligence gathering and analyzing functions work well and that ASIC's investment in investor education makes an important contribution to enabling retail investors to better protect themselves, to recognize scams and to provide ASIC with more timely information on misconduct. They recognize that successful prosecutions, banning orders on individuals, amounts of compensation obtained for investors etc., while one element of measuring the effectiveness of enforcement do not tell the whole story. Other measures of changes in the compliance culture within licensees and among individuals, while qualitative and subjective in nature and therefore inherently disputable, appear to give them confidence that they are making progress. From discussions with various stakeholders there appears to be a general view that ASIC's use of its enforcement powers in recent years has resulted in an improvement in the regard with which ASIC is held. It has prosecuted several high profile cases which have raised matters of public concern going beyond the specific alleged offences. Its success rate in such cases has also improved which has increased its credibility as the enforcement agency in the area of securities and company law.</p>					
Assessment	Broadly Implemented					
Comments	<p>While enforcement by ASIC of the securities and corporate law and market regulation is effective and credible, the rating reflects the relative weaknesses in the supervisory functions carried out with regard to REs, MIS and market intermediaries (particularly Indirect Market Participants and investment advisors) as assessed under Principles 24 and 31. The supervisory approach for REs and MIS seems to rely heavily on external reports, desk-based surveillance, on-site surveillance of limited scope and length and the deterrence impact of ASIC's enforcement activities. Stepping up the proactive surveillance activities seems necessary.</p>					

	In the case of Indirect Market Participants, 600 of approximately 700 participants remain subject only to reactive surveillance. AFSL holders providing investment advice have only recently become subject to ASIC's proactive surveillance activities. This means that a significant percentage of the intermediary population remains uninspected for extended periods of time unless ASIC needs to take action on the basis of breach reports or complaints. Continuing to expand ASIC's proactive supervision program therefore seems necessary.
Principles for Cooperation in Regulation	
Principle 13.	The regulator should have authority to share both public and non-public information with domestic and foreign counterparts.
Description	<p>Domestic counterparts</p> <p>ASIC is able to provide domestic regulators and authorities with confidential information on investigation and enforcement matters in order to assist them to perform or exercise any of their functions or powers and does not require external approval. The list is extensive. The type of information that ASIC is authorized to release is not prescribed. ASIC generally imposes conditions on the use to which the information can be put by the receiving party. Disclosure of personal information, otherwise prohibited under the Privacy Act is permitted; ASIC has discretion as to whether to disclose to a person whose interests are affected by the decision and has procedures to ensure consistency of approach.</p> <p>Foreign counterparts</p> <p>The controls around ASIC's authority to share confidential information with foreign counterparts are more complex. ASIC has authority to share information in its possession with individual foreign agencies (although this does not include agencies acting collectively as in, for example, colleges of supervisors):</p> <p>However, where ASIC does not have the information in its possession and the matter is related to supervision rather than enforcement, there are limitations to ASIC's authority to obtain and share such information. Its information gathering powers cannot be used to collect information or evidence solely for the use of a foreign regulator in an enquiry in which ASIC has no independent interest. If the enquiry relates to an enforcement matter then ASIC will be able assist if the request is dealt with under MABRA.</p> <p>Under MABRA ASIC must obtain the approval of the Treasurer. The issues to which the Minister will have regard comply with those set out in the IOSCO MMOU to which ASIC is a signatory.</p> <p>If a foreign regulator requests assistance for the purposes of an investigation into or proceedings in relation to a criminal matter, it may request assistance under MACMA from the Attorney-General (AG) who has an extensive range of powers including the taking of evidence and identifying, freezing, seizing, or confiscating assets laundered or intended to be laundered. As is the case with the Treasurer the AG's grounds for refusing a request comply with the IOSCO MMOU.</p> <p>Other limitations affect ASIC's powers to share with a foreign regulator information that it has obtained pursuant to the execution of a search warrant obtained under the Crimes Act; that it has obtained from AUSTRAC (the Australian FIU) or that it has obtained under the Telecommunications (Interception and Access) Act 1979 (TIA Act).</p>
Assessment	Broadly Implemented
Comments	Since the 2006 FSAP, while the need for ASIC to obtain approval from a government authority for use of its compulsory powers remains, the function has been transferred from the AG's department to the Treasury which has resourced this function to provide for rapid approval of requests from foreign agencies. These can now be granted in as little as 24 hours. If a request is made under MACMA, the Attorney-General's

	<p>Department will process the request and can provide an indication on the timeframe for a response. The reasons for the broadly implemented assessment arise from the requirement in Principle 13 in the new methodology relating to the importance of information sharing in supervisory as well as enforcement matters and the inability of ASIC to use its powers to obtain supervisory information in some circumstances. The ability of ASIC to share supervisory information with individual foreign supervisors but not with colleges of supervisors limits its ability to play a full part in international supervisory cooperation post the global financial crisis. Colleges of supervisors have become permanent structures for cooperation and coordination among the authorities responsible for and involved in the supervision of the different components of cross-border groups, specifically large groups. Several such groups play a significant role in Australian banking and securities markets. The role of APRA is not so constrained by law; either in sharing supervisory information or in its participation in colleges of supervisors (see s56 APRA Act).</p> <p>The Government is progressing changes to the MABRA Act and Regulations (expected to be in place by the end of 2012), which are intended to allow additional information exchange in certain areas of supervisory cooperation:</p> <ul style="list-style-type: none"> • Amendments to the MABRA Regulations (expected to be in place in Q3 2012) to enable ASIC to respond to requests for assistance from foreign business law regulators and to provide information for general supervisory purposes, thereby removing the current limitation that information can only be obtained by ASIC on behalf of a foreign regulator where there is conduct under investigation (whereas information already held by ASIC can currently be shared with a foreign regulator for supervisory purposes under s127 of the ASIC Act). • Amendments to the MABRA Act to enable ASIC to be given the authorization power to respond to such requests for information and assistance. <p>As at the end of July 2012 the issue of sharing supervisory information in international supervisory colleges remains unresolved.</p>
Principle 14.	Regulators should establish information sharing mechanisms that set out when and how they will share both public and non-public information with their domestic and foreign counterparts.
Description	<p>ASIC enters into documented information sharing agreements with domestic and foreign authorities as a matter of administrative practice to establish agreed processes for the sharing of information. ASIC was one of the first signatories to the IOSCO MMoU. In order to assist it in meeting its responsibility for market surveillance, which it took over from ASX and the other exchanges in 2010, ASIC also attends meetings of the Intermarket Surveillance Group (ISG), although not as a member. The ISG is composed of leading stock and derivatives exchanges that share information and coordinate regulatory efforts so as to address potential Intermarket manipulations and trading irregularities.</p> <p>In addition to enforcement focused MoUs ASIC has entered into several supervisory cooperation efforts with foreign authorities, supported by formal arrangements:</p> <ul style="list-style-type: none"> • New Zealand: In 2008, ASIC and the New Zealand authorities introduced a regime for the mutual recognition of securities offerings. The agencies have established processes for cooperation in administering the mutual recognition scheme supported by a (non-public) MoU. • Hong Kong: In 2008, ASIC signed a bilateral MOU with the Hong Kong Securities and Futures Commission (HK SFC) on the mutual recognition of cross border offering of collective investment schemes. • Canada: In February 2012 ASIC entered into a supervisory cooperation MOU with four provincial securities commissions. This is intended to reflect IOSCO's

	<p>2010 guidance on Supervisory Cooperation. It is however subject to the constraints on ASIC's obtaining and sharing supervisory information described in Principle 13.</p> <ul style="list-style-type: none"> • U.S.: In 2008, ASIC entered into a MOU with the U.S. Securities and Exchange Commission (SEC) concerning consultation, cooperation and the exchange of information related to market oversight and the supervision of financial services firms. In 2010, ASIC and the Financial Industry Regulatory Authority, Inc. (FINRA) entered into a bilateral MOU that covers supervisory cooperation. <p>Confidentiality</p> <p>ASIC is required to take all reasonable measures to prevent unauthorized use and disclosure of information given to it in confidence in or in connection with the performance of its functions, including confidential information received from a foreign regulator. Its practice is consistent with Art. 11 of the IOSCO MMOU. In certain circumstances, when ASIC has discretion to release confidential information, it also has the power to impose conditions concerning use and pre-publication notification. In the case of requests under freedom of information legislation in Australia it may refuse to release the information. However, if ASIC receives a legally enforceable demand for the information or wants to use it for a purpose other than that set out in the request for information or permitted by the MOU ASIC will consult with the foreign regulator and assert any appropriate legal privileges in relation to the confidential information on behalf of the foreign regulator.</p> <p>Information sharing is managed by ASIC's International Cooperation Requests team (ICR). During the 2009-10 and 2010-11 financial years ICR managed 980 requests for assistance from other foreign regulators and agencies. Requests for assistance were for enforcement related assistance, policy based information, probity (or due diligence) enquiries and visits to ASIC. Only 3 or 4 a year are refused.</p>
Assessment	Fully implemented
Comments	<p>Although a bilateral MOU is not a precondition to information being shared by ASIC, it will usually respond positively to an offer to negotiate an MOU and do what it can to facilitate negotiating an MOU with a foreign regulator. Effective cooperation arrangements, such as the IOSCO MMOU, are however required before ASIC will give relief to foreign financial service providers, market operators or collective investments schemes from certain licensing, registration and disclosure requirements as permitted under the law.</p>
Principle 15.	<p>The regulatory system should allow for assistance to be provided to foreign regulators who need to make inquiries in the discharge of their functions and exercise of their powers.</p>
Description	<p>As described in Principle 13 ASIC's ability to provide assistance to a foreign regulator is conditional on the general principle that if it does not have the information requested in its possession, its information gathering powers cannot be used to collect information or evidence solely for the use of a foreign regulator in an enquiry in which ASIC has no independent interest unless the matter is related to enforcement (i.e., not merely inspection or supervision).</p> <p>If the request meets these criteria (that is, they relate to enforcement, or ASIC has an independent interest), ASIC can assist in providing the full range of necessary information such as contemporaneous trading (including amount, price and time of execution) and bank account records, account holder names (and trader names if different), executing broker or bank (and trader) ID, beneficial owners or controllers of legal entities located in Australia. As regards requests concerning insider dealing,</p>

	<p>market manipulation, misrepresentation of material information and other fraudulent or manipulative practices relating to securities and derivatives, including solicitation practices, handling of investor funds and customer orders, the criteria are likely to be met. In other cases, such as requests for information on the registration and sale of securities and derivatives, on licensed persons such as brokers and investment advisors, products such as collective investment schemes, and market infrastructure providers such as exchanges and clearing houses, it may be less clear that ASIC can assist, as these requests may relate to supervision only, and ASIC may have no independent interest. In 2010-2011 there were 44 requests made under the IOSCO MMOU. They identified the information described in the first category above (insider dealing etc.) in 31 requests; securities and derivatives registration and sale in four requests; and brokers, products etc. in 12 requests. A number of the requests related to more than one type of information.</p> <p>Within the legislative constraints noted above ASIC believes that it provides effective assistance. The type of information, documents or evidence that may be shared or obtained is not prescribed in the ASIC Act, MABRA or MACMA. If a request is dealt with under MABRA, ASIC could readily obtain records given its extensive compulsory information gathering powers and the obligations on AFSL holders to maintain records of this sort. This includes information on financial conglomerates where parts of the conglomerate are subject to its supervision. ASIC provides assistance in a timely way. The time taken to respond to requests by foreign regulators for assistance takes from 33 (the average response time for research requests) to 58 days (the average response time for enforcement requests) and averages 44 days overall. Information such as on regulatory processes and holders of licenses is generally public and within ASIC's possession and requests are processed accordingly. In ASIC's view the time it takes to respond is consistent with its experience in receiving responses to its enquiries made to foreign regulators.</p> <p>Under MACMA, a foreign country may make a request to the Attorney-General for conducting various elements of an investigation including the collection of evidence, taking of statements under oath, production of documents and the freezing and seizure of criminal assets or proceeds of crime.</p> <p>ASIC does not have the power, where it does not have an independent interest in a matter, to use its statutory powers to obtain court orders (including the power to seek an urgent injunction) at the request of a foreign regulator. However, in certain circumstances a judgment that has been obtained in a foreign country can be treated as a judgment of an Australian court and enforced in Australia under the Foreign Judgments Act 1991. If the Foreign Judgments Act does not apply, a foreign judgment may be able to be enforced at common law. However, the common law also does not recognize foreign judgments that impose a penalty.</p>
Assessment	Broadly Implemented
Comments	As with Principle 13, the reasons for the broadly implemented assessment arise from the requirement in the new methodology relating to the importance of information sharing in supervisory as well as enforcement matters and the inability of ASIC (whether at its own initiative or via MABRA, with the approval of the Treasurer), to use its powers to obtain supervisory information.
Principles for Issuers	
Principle 16.	There should be full, accurate and timely disclosure of financial results, risk and other information that is material to investors' decisions.
Description	<p>Prospectuses</p> <p>The important change as regards Principles 16-18 since the 2006 assessment is that ASIC has recently released a "final and comprehensive" regulatory guide on prospectus</p>

disclosure Prospectuses: Effective disclosure for retail investors (RG 228). This addresses the recommendation that ASIC should issue a comprehensive policy statement on guidance on prospectus disclosure. It is intended to enhance public clarity as to ASIC's interpretation of the disclosure requirements under the CA, and to assist issuers (and their advisors) to produce disclosure documents that help retail investors assess the offer and make informed investment decisions. Topics covered include how to set out the most significant risks of investing in the security and important relevant information about the issuer and its activities. Since 2006, ASIC has also updated a number of RGs and issued guidance on specific disclosure issues, such as RG 69 - Debentures and unsecured notes: Improving disclosure for retail investors, which sets out ASIC's prospectus guidance for offers of debentures and convertible notes to retail investors; and RG 213 - *Facilitating debt raising*, which sets out ASIC's relief and prospectus guidelines for offers of simple "plain vanilla" bonds. ASIC has made public that in reviewing a prospectus it will have regard to the issuer's obligations under the CA and also the extent to which the ASIC guidance has been followed.

For the purposes of Australia's disclosure requirements, 'securities' is defined by the CA to include shares, debentures, legal or equitable rights or interests in shares and debentures, and options to acquire shares or debentures (or an interest in such option). Corporate bonds and convertible notes fall under this definition of securities. Products which do not fall into the definition of securities are captured by the financial products disclosure regime. The applicable regime will, therefore, depend on the particular terms and features of the product. Asset backed securities would generally be treated as securities. Derivatives (other than options to acquire shares or debentures) and warrants (with most structured products in Australia being warrants) are generally regarded as financial products and therefore subject to the financial products disclosure regime.

An offer of securities for issue by any entity, whether or not it falls within the definition in the CA of a public company (one with more than 50 non-employee shareholders), requires a disclosure document unless the offer is exempted (s706 CA). A prospectus is the most common disclosure document. Others, namely offer information statements and profile statements have conditions attached. The circumstances when an offer of securities for issue is exempted from the disclosure requirements are set out in s708CA. These include offers made to sophisticated, experienced or professional investors as defined in s9 CA. In practice companies often make such offers on the basis of prospectus level disclosure as professional investors demand this level of information. In all cases the normal anti-fraud provisions of the law continue to apply. As such the exemptions from a statutory disclosure requirement are similar to (though different in detail from) similar regimes in, for example, the EU and the United States. The Australian regime also has similar mechanisms to these jurisdictions intended to minimize the risk of onward sales to persons who could have been offered the securities on issue only if the offer had been accompanied by a prospectus.

For public offerings of securities there is a clear and comprehensive regulatory framework which requires the preparation of disclosure documents, specifies the minimum required content and establishes a process for the distribution of disclosure documents and the offering of securities. A person must not make an offer of securities for issue until a disclosure document for the offer has been lodged with ASIC, unless the offer is exempted, as noted above. In addition, rights offerings of securities in the same class as those already quoted on a financial market do not require a formal disclosure document as the issuer is subject to the continuous disclosure regime (see below) which ensures that relevant information available since the last annual or half yearly report is in the public domain. In these cases the issuer is required to issue a 'cleansing notice', which sets out any material information concerning the securities not already disclosed to the market. This must be issued 24 hours prior to the offer. As noted above, a prospectus is the most commonly used standard disclosure document

and has the broadest information requirements. Stock exchange listing requirements also set out the information issuers are required to disclose where securities are to be listed on a stock exchange. A short form prospectus may be used for any offer. Instead of setting out material that has been lodged with ASIC, the short form prospectus may refer to this material. If this occurs, the short form prospectus must identify the document and inform the readers of their right to obtain a copy.

A prospectus must make disclosure in compliance with the 'reasonable investor' test. This requires the disclosure in the prospectus of all information that investors and their advisers would reasonably require in order to make an informed assessment of the rights and liabilities attaching to the securities offered and the assets and liabilities, financial position and performance, profits and losses and prospects of the body that is to issue the shares, debentures or interests in a managed investment scheme. Although the CA sets out in a little more detail what this information should refer to, issuers and their advisers now have to read these requirements having regard to the ASIC RGs referred to above. Furthermore a disclosure document must be worded and presented in a clear, concise and effective manner. Taken as a whole the regime meets the test of ensuring that the information presented to investors is of sufficient quality to enable them to make an informed assessment of the issuer and the investment. It is an offence to continue making an offer after the offeror has become aware of a misleading or deceptive statement, omission or new circumstance that is materially adverse unless the deficiency is corrected via a supplementary or replacement disclosure document.

A disclosure document to be used for an offer of securities must be lodged with ASIC. A person must not accept an application for non-quoted securities offered under a disclosure document within seven days (the exposure period) after submission of the disclosure document to ASIC. This seven day period is known as the exposure period. An offeror of non-quoted securities is expected to make its disclosure document generally available during the exposure period. ASIC may exercise its discretion to extend the exposure period for up to an additional seven days, for example, where it appears that the disclosure document may be defective. After the exposure period has ended, and ASIC has no concerns about the disclosure document, the offeror may accept applications for the issue of securities. If at the end of the extended exposure period ASIC still has concerns the disclosure document may be defective, ASIC may issue an interim stop order for 21 days. This might become permanent if the problem cannot be resolved by the issuer.

A disclosure document for an offer of quoted securities is not subject to an exposure period. If ASIC has a concern that a disclosure document for an offer of quoted securities is defective then it can, at any time after the disclosure document is lodged, issue an interim stop order for 21 days. This might become permanent if the problem cannot be resolved by the issuer.

A person cited in a disclosure document with their consent is liable for loss or damage caused by the relevant statement. An unsolicited offer of securities through a meeting or via telephone is also prohibited by the CA. ASIC has granted relief from the prohibitions against advertising and other publicity about offers of securities before the disclosure document has been lodged with ASIC for road-show presentations and market research subject to certain conditions.

ASIC has the power to provide relief from the disclosure provisions in Chapter 6D of CA. For the period 1 July 2010 to 30 June 2011, ASIC received 219 applications for fundraising relief, of which 146 were granted.

Annual reports

The CA states that a financial report and directors' report must be prepared for each financial year by all disclosing entities (listed or unlisted), public companies, large proprietary (private) companies and registered managed investment schemes. Unlisted

disclosing entities are bodies (mostly companies) with 100 or more members holding securities as a result of an issue under a prospectus, or as consideration for an acquisition under an off-market takeover bid or a scheme of arrangement (see Principle 17).

The CA contains general and specific content requirements for the annual financial report and the annual directors' report, with special rules for public and listed companies. The financial report for a financial year must consist of the financial statements for the year, the notes to the financial statements and a directors' declaration about the statements and notes. Annual financial reports must be audited. For listed entities the chief executive officer and chief financial officer are required to give a declaration to the directors as to whether the financial records have been properly kept, and whether the financial statements and notes comply with the accounting standards and give a true and fair view. The requirements for the directors' report are extensive. For listed companies information must be provided concerning remuneration of key management personnel. The making of an incorrect declaration by a director can be subject to civil and criminal sanctions including disqualification, fines and imprisonment. For the first six months of 2011 five companies were prosecuted by the CDPP under the criminal law for a number of offences, including failing to lodge annual reports. For entities listed on the ASX, there were 16 entities that failed to lodge their full-year accounts for the period ended 30 June 2011 by the due date of 30 September 2011, and consequently were suspended by the ASX on 3 October 2011 in accordance with the ASX Listing Rules.

ASIC has the power to grant relief from the requirements in relation to financial reports and audit reports to a company, registered scheme or disclosing entity, its directors, and/or its auditor. ASIC can only grant relief if it is satisfied that complying with the CA would: (i) make the financial report or other reports misleading; (ii) be inappropriate in the circumstances; or (iii) impose unreasonable burdens. For the period 1 July 2010 to 30 June 2011, ASIC received 270 applications for financial reporting relief, 126 of which were granted. ASIC may also exercise its power to extend the time for holding an annual general meeting.

Half year reports

Listed companies and disclosing entities must also prepare half year financial and directors' reports, obtain an auditor's review report and lodge them with ASIC. The CA specifies the information that the half year financial report and directors' report must contain. This report does not need to be audited but must comply with accounting standards and present a true and fair view of the financial position and performance of the entity. Unlike a full audit report the auditor's view is in the negative, that is, the auditor has no reason to believe that the financial report does not comply with accounting standards and does not give a true and fair view.

Shareholder voting decisions

As regards shareholder voting decisions, the CA provisions cover a wide range of issues from members' rights to call meetings through to the dissemination and recording of meeting particulars and resolution outcomes. In this area, the CA covers disclosure in a range of circumstances. For example a listed company must give 28 days' notice of a meeting. In addition there is a body of case law which has clarified what level of detail is required in a notice of meeting. In addition to the notice of meeting provisions, the CA provides for members to obtain relevant information at the Annual General Meeting ('AGM') of a company. Companies, registered managed investment schemes, and other disclosing entities are under an obligation to send members a copy of their yearly financial report, directors' report and auditor's report, or alternatively, a concise report by the earlier of 21 days before the AGM or four months after the end of the financial year (three months in the case of listed companies). Listed companies

must inform ASX (for publication) of the outcome in respect of each resolution put to the meeting of security holders immediately after the meeting has concluded. Related party transactions are permitted if the company's members approve the transaction or giving the financial benefit falls within an exception set out in the CA. The CA sets out how members' approval is to be obtained. ASIC must be notified of the intention to seek members' approval 14 days in advance.

Obligation of continuous disclosure

Australia operates a rigorous system of continuous disclosure which seeks to ensure that investors have access to specific and timely disclosure of information and events that are material to the price or value of securities. The CA imposes a continuous disclosure obligation on an unlisted disclosing entity. For listed companies this regime operates through the listing rules of those exchanges that list securities—primarily ASX. These requirements oblige listed entities to disclose to the market events that are material to the price or value of the relevant listed securities. For ASX listed entities, there are corporate governance principles against which specific disclosures must be made. In recent years several high profile cases brought by ASIC are generally acknowledged to have increased directors' awareness of their obligations under this regime and consequently to have improved corporate disclosure. Derogations from the requirement to disclose are available in certain circumstances, generally concerning confidentiality, incomplete negotiations and lack of specificity.

ASX Group has frontline responsibility for monitoring compliance with the continuous and periodic disclosure requirements of the ASX Listing Rules. In a dedicated Listings unit, a team of advisers and a Surveillance team are tasked with identifying potential breaches of the disclosure requirements. Each listed entity is assigned a dedicated Listings adviser, who is its first point of contact regarding any issues it may have under the Listing Rules. A Listings adviser's day-to-day role includes reviewing all media commentary in major and national newspapers to identify reports about listed entities, and determining whether disclosure is required and reviewing all information released to ASX's centralized announcement processing office (Markets Announcements Platform) to determine whether additional or clarifying disclosure is required, and whether other Listing Rules have been complied with.

The ASX encourages listed entities to request a trading halt if a company feels it may have information that could have a material effect on the price of its securities. Trading recommences after a company announcement has been made to the market. ASX agrees to requests by entities for trading halts on a regular basis. In the period from 2010-2012, there were 97 instances in which ASX imposed a trading halt at the request of the listed entity. ASIC recommends that companies using the derogation have a press release ready for immediate publication in case the derogation no longer applies (e.g., because the confidential information has leaked). Unlisted disclosing entities must disclose to ASIC and will generally publish on their web sites. Insider trading prohibitions deter trading by persons with price sensitive non-public information. ASIC has the power to direct a market operator to suspend dealings in a financial product or class of financial products, if it is necessary, or in the public interest, to protect people dealing in that product. The direction may last for up to 21 days.

Non-compliance with the continuous disclosure requirements in the listing rules is an offence punishable with a fine of A\$22,000 or imprisonment for five years or both. Where a corporation is convicted of the offence, the maximum penalty is five times the amount that could be imposed on an individual. It may also result in the imposition of a civil penalty of up to A\$1 million in the case of a corporation or A\$200,000 in the case of an individual who is involved in the breach. ASIC may also issue an infringement notice. For an initial and subsequent contraventions, infringement notice fines range from A\$33,000 to A\$100,000. Since 2004 ASIC has issued 20 infringement notices for alleged continuous disclosure breaches.

As to the timeliness of disclosure the CA imposes a number of timing deadlines which depend on the nature of the information provided. For example, listed companies' annual financial statements must be released within three months (four for unlisted companies) of the end of the financial year. Half year reports must be lodged with ASIC within 75 days after the end of the half year (s320 CA). These and other deadlines are consistent with accepted international standards. In addition to providing reports to shareholders companies must lodge them with ASIC, so that members of the public can obtain them for a fee from an information broker or an ASIC service center.

There are various mechanisms in place which seek to ensure a high standard of corporate disclosure. ASIC conducts a regular review program of financial reporting by listed entities and significant unlisted entities. Until recently, ASIC could refer a financial report to the Financial Reporting Panel (FRP), if it was of the opinion that the report did not comply with the financial reporting requirements. If the report did not comply, the FRP was required to prepare a report and set out the changes that would need to be made to ensure compliance. ASIC publicized the report and set out the changes recommended by the FRP. If the report related to a listed company, the market operator was required to also make the report available to users of the market. In August 2010 ASIC referred four matters to the FRP. The FRP ruled in favor of ASIC in two of these matters; in the other two matters the FRP ruled in favor of the companies involved. On February 7, 2012 the Federal Government announced that the FRP would be wound up due to lower than expected referral rates. Following the Government's announcement, ASIC is still able to seek a court injunction requiring a company to correct its financial report to comply with the financial reporting requirements of the CA.

Market operators may also take action to address disclosure concerns. For example, if the ASX considers that there may be a false market for a listed entity's securities, it can require the production of documents to correct or prevent that false market. ASIC estimates that on average ASX makes around 35-40 queries under ASX Listing Rule 3.1B per year. This equates to around 15 percent of all continuous disclosure queries being under ASX Listing Rule 3.

Cross-border matters

Provisions in the CA governing fundraising in Australia apply to offers of securities that are received in the jurisdiction, regardless of where any resulting issue, sale or transfer occurs. As such, foreign companies that offer securities in Australia need to comply with the prospectus provisions in the CA unless an exemption applies. This approach follows and is consistent with the materiality principle as outlined in IOSCO's International Disclosure Standards for Cross-border Offerings and Initial Listings by Foreign Issuers. ASIC has the power to exempt foreign issuers from particular provisions of the CA. Since 1 July 2008 ASIC has received 39 applications for relief for foreign issuers, of which limited technical relief was granted in 31 applications, relief refused in four matters, with four applications for relief withdrawn.

Specific provisions apply to offers of securities in New Zealand and Australia under mutual recognition. The trans-Tasman mutual recognition scheme for offers of securities promotes investment between Australia and New Zealand and allows an issuer to offer securities or interests in managed or collective investment schemes in both countries using one disclosure document prepared under the fundraising laws in its home country. Under the mutual recognition scheme, issuers are not required to comply with most of the requirements of the other country's fundraising laws. Instead, issuers who wish to operate under the scheme are able to comply with some minimal entry and ongoing requirements. Under the mutual recognition scheme, ASIC, the New Zealand Securities Commission and the New Zealand Companies Office exercise their usual powers for offers of securities.

	<p>ASIC operational organization</p> <p>Primary responsibility for reviewing prospectuses, M&A/takeover documents, related party and independent expert reports resides with the Corporations (COR) stakeholder team and the Emerging Mining and Resources (EMR) team in Perth. The teams also conduct surveillances in relation to disclosure and conduct obligations of corporations. Of the 58 staff, 20 are engaged in document review. In 2010/11 they processed 919 prospectuses versus a 2006/7 peak of 1227; they extended exposure periods in 73 instances and issued 20 interim stop orders. A prospectus can take from 2 hours to a day to review. At the current business level all prospectuses are fully reviewed but COR has a risk based process should an increase in volumes make this impossible at current staffing levels. Financial statements of listed companies are reviewed by Financial Reporting and Audit (FRA) as part of the work of their 40 staff. The Markets and Participants Supervision (MPS) team undertakes surveillance work in relation to ongoing market disclosures.</p>
Assessment	Fully Implemented
Comments	<p>The Regulatory Guides that ASIC has released in this area since 2006 set out simply and clearly the information that ASIC expects to see in a prospectus and the way that information is to be presented so as to enable prospective retail investors to better focus on the key issues involved in making a decision on whether to subscribe for the shares or bonds. They significantly flesh out the CA requirements and have been an addition to the disclosure regime for public offerings necessary to elevate the regime to the standard required by the IOSCO Principle. RG 69 - Debentures: Improving disclosure for retail investors is particularly noteworthy. Written in response to significant losses to retail investors in this product, it sets out a series of eight benchmark ratios which help investors better understand the risks in the product.</p> <p>ASIC has a long standing policy of bringing cases to court against companies, company directors and their professional advisors for breach of their obligations under the continuous disclosure regime. Until recently ASIC's low success rate has been a cause for public concern. Recent court decisions in several high profile cases have found in favor of ASIC, usually on appeal. The consensus view is that these cases have sent clear signals to directors as to what their responsibilities are under the law, have strengthened ASIC's powers to enforce the continuous disclosure regime and appear to have enhanced ASIC's reputation as an effective and credible enforcement focused market and corporate regulator.</p> <p>In a measure which will resonate globally in the debate on executive compensation, in July 2011 the Government introduced a change to the CA, known as the "two strike rule", which says that if more than a quarter of shareholder votes are cast against a company's remuneration report for two years in a row, it triggers a further vote – on a straight majority – requiring all directors to face re-election. Normally, once a chief executive (also known as a managing director) has been elected to the board in Australia, he or she does not have to stand again, while other directors must stand every three years (see ASX Listing Rule 14.4). Until the law change the vote on pay at the AGM was advisory not binding; it was possible for companies to take no action even if the remuneration report was voted down. Around 12 companies are facing this prospect during the AGM season. However, while the directors cannot vote on the remuneration report they are able to vote for their own re-election. Where the directors are large shareholders the final outcome may not be so different to the status quo.</p>
Principle 17.	Holders of securities in a company should be treated in a fair and equitable manner.
Description	<p>The rights of security holders of public companies are set out in a combination of the CA, the ASIC Act, stock exchange rules for listed companies, and judicial decisions. Each of the enumerated topics ((a) to (h)) set out in key question 1 of the Assessment Methodology is covered by one or more of these requirements and generally results in</p>

equitable treatment of voting security holders. Generally, security holders have the right to vote on changes that affect the terms of the securities they hold and on certain other fundamental changes. The company must provide reasonable notice and material information about all matters to be voted on at a security holder meeting. Particular requirements apply to takeovers, schemes of arrangement and share buy-backs. Full disclosure of all information material to an investment or voting decision required in connection with shareholder voting decisions is required to be provided generally and in relation to takeovers, schemes of arrangement, and member-approved acquisitions.

Changes of control

The fundamental principle underpinning the CA and ASIC's RGs and interventions in changes in corporate control is to ensure as far as practicable that they are orderly and equitable and occur in an efficient, competitive and informed market. The key elements of the process are to secure that:

- full disclosure of all information material to an investment or voting decision is provided to holders of voting shares or interests;
- holders of voting shares or interests are given a reasonable time in which to consider the proposal;
- as far as practicable, holders of voting shares or interests are given a reasonable and equal opportunity to participate in any benefits accruing to the holders under the proposal.

The conduct of participants is regulated by ASIC and disputes between participants are resolved by the Takeovers Panel. Australian takeovers legislation applies to takeovers of companies or other bodies corporate which are registered in Australia and are listed on a prescribed financial market (ASX, NSX, BSX, or APX) or that are public companies (i.e., they have at least 50 shareholders). Unusually in a global context it also applies to takeovers of listed managed investment schemes (CIS).

Although takeovers have traditionally been achieved through the mechanism of a takeover bid, there are a number of alternative mechanisms available for achieving a similar outcome. These alternatives include schemes of arrangement, share buy-backs and shareholder approved acquisitions. The first has been used with increasing frequency in recent years. The control threshold in a takeover bid is 20 percent and the takeovers prohibition applies to any acquisition of relevant interests in voting shares above that level. There is a lower threshold of 5 percent for public notification of substantial holdings in listed companies. The CA limits the ways in which a person can acquire a relevant interest in the voting shares of a company where the voting power of any person increases from 20 percent or below to more than 20 percent or from above 20 percent until 90 percent to the following permitted ways:

- market bids;
- off-market bids;
- schemes of arrangement, liquidator's arrangements or share buy backs;
- shareholder approvals in general meeting;
- 3 percent creeping acquisitions;
- pro rata rights issues; and
- downstream acquisitions.

The 3 percent creep exception in item 9, s611 CA is anomalous. It allows a major holder to gradually increase its relevant interest in a company's voting shares without making a takeover bid (but subject to disclosure). The policy rationale was not explicitly described by the legislature. Therefore the 3 percent creep exception may or may not, depending on the circumstances, result in a gap in the fair and equitable treatment of holders of securities in a change of control situation. However, while the 3 percent creep exception is an exception to the principles set out above and articulated in the

CA, it is open for the Takeovers Panel to make a finding that conduct authorized by item 9, s611 CA constitutes unacceptable circumstances pursuant to s657A CA. ASIC wrote to the Treasury in July 2012 suggesting consideration be given to removing the creep exception.

The concept of associates is broad, so that votes controlled by persons associated with the primary person are included in the primary person's voting power. People who act in concert in relation to voting power matters will also be treated as associates. As is not unusual in most jurisdictions, establishing that persons are acting in concert when they seek to hide that fact is difficult. It is ASIC's responsibility to seek to identify concert parties and take action against them but that can be expensive and time consuming if the trail leads through multiple foreign jurisdictions. The Deterrence team has to decide the priority to accord such work taking account of its other enforcement cases running at the time.

An off-market bid is the most commonly used takeover method. The bidder prepares a bidder's statement which is sent to shareholders by mail. The target prepares a target's statement which is also mailed to shareholders and includes the target directors' recommendations. The offers are accepted by shareholders completing and returning acceptance forms prior to the expiry date. Offers can be for cash and shares, only cash or only shares or another type of security.

The bidder's statement must include:

- details of the bidder and its intentions regarding the target's business, assets and employees;
- how the bidder is funding the cash component of the purchase consideration (if any);
- information on any consideration the bidder provided for a security in the bid class under a purchase or agreement during the 4 months before the date of the bid;
- information on any benefit offered during the 4 months before the date of the bid, to a shareholder but not all other shareholders, that was likely to induce the shareholder to accept an offer under the bid or dispose of securities in the bid class; and
- any other information known to the bidder that is material to a target shareholder deciding whether to accept the offer.

Where the bidder is offering shares or other securities as consideration under the offer, the bidder's statement must contain the same level of disclosure as a prospectus, so that target shareholders are given enough information to properly assess the bid and make their decision. However, if the shares (or other securities) offered as consideration have been continuously quoted by the ASX or another prescribed financial market during the previous 12 months, reduced disclosure rules apply, as the bidder will have been subject to the continuous disclosure regime of the ASX, NSX, BSX or APX during that period.

The target's statement is the formal response of the board of the target company. It is intended to give shareholders enough information to decide whether or not to accept the bid. Defenses available to takeovers in Australia are limited. The ASX Listing Rules contain several important limitations on defensive actions by listed companies. There is also the possibility that a defense will be deemed to amount to a frustrating action which could be the subject of a declaration of unacceptable circumstances by the Takeovers Panel (see below). Furthermore the fiduciary duties to which directors are subject under the CA may limit the range of defensive actions available to the target company.

The consideration offered by the bidder must be not less than the highest price at which any bid class securities were acquired by the bidder or an associate in the target company's shares during the preceding four months. This is somewhat shorter than in

many jurisdictions. Also, Australian law does not impose a requirement that purchases by the offeror after the successful completion of the bid must also be no higher than the bid (in which case the bid price must be raised to that new level).

Off market takeovers must remain open for a minimum of one month and may not exceed 12 months in duration. Offers are automatically extended by another 14 days if during the final seven days of the offer period the offer consideration is improved or the bidder reaches 50 percent voting power. A market bid is carried out by the bidder purchasing the target's securities on market for cash only. A market bid must be an unconditional cash offer for all of the quoted securities listed on a prescribed financial market. In essence it involves a member of a prescribed financial market acting on behalf of the bidder by making an announcement that it will stand in the market and purchase all shares offered at the offer price for a minimum period of one month. The market bid commences 14 days after the bid announcement is made.

Squeeze out provisions

The takeover legislation contains a procedure for the majority holder to compulsorily acquire minority holders' securities following the bid, and follows international good practice in seeking to balance the rights of the majority to gain the benefits of the full acquisition of the target against the rights of the minorities.

If at the end of the offer period the bidder (and its associates) have relevant interests in at least 90 percent of the securities (by number) in the bid class and have acquired at least 75 percent (by number) of the securities that the bidder offered to acquire under the bid, the bidder may compulsorily acquire securities in the bid class. The remaining holders of bid class securities must be notified by the bidder of its entitlement to acquire their securities.

If at the end of the offer period the bidder (and its associates) have relevant interests in at least 90 percent of the securities (by number) in the bid class, the remaining holders of bid class securities (and other securities convertible into bid class securities) have a right to be bought out and must be notified of that right. The bidder needs to offer to acquire the securities at the same price as under the bid.

There is also a general compulsory acquisition power within 6 months of a holder obtaining full beneficial interests in 90 percent of a company. In this case a report valuing securities by an expert nominated by ASIC is also required. If 10 percent of the minority objects, the 90 percent holder must obtain court approval.

ASIC's role

ASIC regulates mergers and acquisitions. It generally reviews all of the bidder's and target's statements once they are lodged to ensure that they comply with the disclosure obligations as set out under the CA. For the period 1 July 2010 - 30 June 2011 the COR and EMR teams reviewed all 132 original bidder's and target's statements lodged with ASIC and all 155 supplementary bidder's and target's statements lodged with ASIC. If ASIC raises concerns with the bidder (or target) about the disclosure in their statements, the bidder (or target) will provide corrective and/or additional disclosure which addresses ASIC's concerns. This revised disclosure is generally by the issue of a supplementary statement to shareholders advising of the changes. Where possible, for example, where a bidder's statement has been lodged with ASIC but has not yet been sent to shareholders, the bidder will lodge a replacement bidder's statement. All statements made during takeover bids must not be misleading or deceptive. During the offer period, ASIC monitors statements made by market participants in relation to the bid. ASIC can also provide relief from elements of the takeover provisions of the CA.

Section 671B CA requires a person who begins or ceases to have a substantial shareholding (defined in s9 as a relevant interest in five percent of votes) in a listed company or listed MIS, a person who has a substantial shareholding whose holding

moves at least one percent and a person who makes a takeover bid to notify both the entity and the market operator. This information is published by the market operator. Information required to be given to the company and each relevant market operator includes the person's name and address and voting shares in the company. If a takeover bid is made or the person becomes aware of the change during a takeover bid, the information must be provided by 9:30 am of the next trading day. In other situations, the information must be provided within two days of becoming aware of the information (s671B CA).

ASIC has the power to provide relief from the takeover provisions of Chapter 6 of CA. For the period 1 July 2010 to 30 June 2011 ASIC received 261 applications for takeover relief, of which 102 were granted. ASIC makes its decisions in individual cases based on the facts and having regard to the principles set out in s602 CA. The equal opportunity principle is particularly relevant and so ASIC has regard to whether the consideration offered to existing shareholders is fair and equitable.

Takeovers Panel

Unlike similarly named and structured bodies in other countries such as the UK, the Panel does not regulate the conduct of the parties to a takeover. That is the responsibility of ASIC. Instead the panel is a dispute resolution mechanism. The 57 members of the Panel are appointed by the Minister from among takeover practitioners, lawyers, investment bankers and fund managers, who are called to adjudicate when required. The Panel may review any ASIC decision to exempt or modify the takeovers law, on the application of any person whose interests are affected by the decision. It may also make a declaration of "unacceptable circumstances" on the application of the bidder, the target, ASIC or any other person whose interests are affected by the relevant circumstances. Where the Panel makes a declaration of unacceptable circumstances, it may make a wide range of orders, which may be enforced by court order. The court can also quash an order although this is very rare. The concept of unacceptable circumstances covers actual breaches of the law as well as breaches of the spirit of the law. The Panel deals with approximately 30 applications a year.

Schemes of arrangement

Schemes of arrangement can be used to effect a change in control of a corporation. Schemes of arrangement are binding, court-approved agreements that allow the reorganization of the rights and liabilities of members and creditors of a company. If the scheme of arrangement gains the necessary creditor and/or member approval, then an application can be made to the court for approval of the scheme. The approval threshold by members and creditors is twofold: (i) it requires 50 percent of members who decide to vote in favor (50 percent headcount requirement); and (ii) it requires 75 percent in issued voting shares to vote in favor (75 percent share count threshold). In considering the application, the court has to be satisfied that the necessary approval of members was obtained, and that it is appropriate for it to exercise its discretion and approve the scheme. The interests of shareholders are one of the considerations taken into account by the court in exercising its discretion. Before the court can make such an order, the court needs to be satisfied that:

- ASIC has been given 14 days notice of the application to the court;
- ASIC has been given a reasonable opportunity to examine the proposed terms of the scheme of arrangement and a draft explanatory statement; and
- ASIC has been given a reasonable opportunity to make submissions to the court in relation to the proposed compromise arrangements and the draft explanatory statement.

Acquisitions resulting from a buy-back

Shareholder approval is usually required for buy-backs unless an exemption applies. Furthermore, ASIC may apply to the Takeovers Panel for a declaration of unacceptable circumstances if ASIC considers the buy-back is unreasonable. For buy-backs of a significant proportion of a company's shares, or transactions with a major shareholder, ASIC policy is that it is usually appropriate for shareholders to have the benefit of independent advice on whether to vote for a buy-back.

Shareholders' rights and remedies

Shareholders and the company have rights to hold directors and senior management accountable for their involvement or oversight resulting in violations of law. With leave of the court, any member (shareholder) of a company or related body corporate may bring or intervene in proceedings on behalf of a company, for example, against the company's directors for breach of duty. The court must grant the application if it is satisfied that:

- It is probable that the company will not itself bring the proceedings;
- The applicant is acting in good faith;
- It is in the best interests of the company that the application be granted leave; and
- There is a serious question to be tried.

Even if members have ratified the conduct, it does not prevent this ability to bring or intervene in proceedings with leave.

Shareholder rights in bankruptcy proceedings

The CA governs provisions regarding external administration of a company. In relation to the treatment of members, all members are generally treated equitably. For example, the following provisions apply to all members of a corporation:

- An alteration in the status of members during a liquidation is void unless sanctioned by the liquidator;
- An alteration in the status of members during an administration is void unless ordered by the court;
- In a liquidation, a member of a company limited by shares is liable for the unpaid amount of shares in respect of present and possibly past membership; and
- Payment of a debt in a liquidation, including by way of dividends, to a member is postponed until all other debts have been satisfied.

In addition, the CA confers on shareholders certain rights during an external administration, rights that are available to any respective shareholder. These shareholder rights include the:

- Right to apply to the court for a review of a liquidator's remuneration in certain circumstances
- Right to apply to the court to stay the court winding up
- Right to apply to the court to have questions determined in a creditors' voluntary winding up
- Right to require the liquidator to convene a meeting in certain circumstances, if the applicant meets the cost of calling and holding the meeting (for example, for a court winding up).

Directors' interests

A director of a listed company must notify the market operator of a prescribed financial market of any interests in its securities (see for example ASX Listing Rule 3.19A.2). The reporting deadline is 5 business days of such change. The notifications are made public via the ASX's company announcements' platform. Such information must also be

	<p>provided in the annual report and any prospectus. Directors of unlisted companies must notify ASIC within 14 days (s205G CA). This information is publicly available in the ASIC database.</p> <p>The CA also requires that any director (or proposed director) discloses the nature or extent of any interest that he or she holds or has held in the last two years in:</p> <ul style="list-style-type: none"> • The formation or promotion of the company; • Property acquired or proposed to be acquired by the company in connection with its formation or promotion, or the offer of securities; and • The offer of securities. <p>The annual report for a listed company must include the following details for each director:</p> <ul style="list-style-type: none"> • Their relevant interests in shares of the company or a related body corporate; • Their relevant interests in debentures, or interests of a registered managed investment scheme; • Their rights or options over shares; • Contracts under which directors are entitled to a benefit or that confer a right to call for or deliver shares or debentures; and • All directorships of other listed companies held by the directors. <p>Cross-border change of control</p> <p>Foreign companies issuing securities under foreign share offers are exempt from certain disclosure provisions in the CA (for example, continuous disclosure requirements) in relation to securities issued as consideration for an acquisition under an off market takeover bid, compromise or arrangement. There is a requirement, however, that the terms of the conditions to Australian citizens and permanent residents are the same as those applying to other persons. ASIC has also provided class order relief from some technical requirements to foreign takeovers and schemes of arrangement.</p>
Assessment	Fully Implemented
Comments	<p>ASIC regulates the conduct of takeovers and other means of securing control or a change of control while the Takeovers Panel operates as a peer-based disputes resolution mechanism (with recourse to the courts as a last resort). This separation of powers appears to work effectively and to have widespread acceptance among corporations, their professional advisors and the public.</p> <p>Schemes of arrangement, whereby the court is the arbiter and ASIC acts in an advisory capacity to the court are gaining in frequency of use. It is said that the process is simpler and cheaper, effective control is easier to obtain and directors' obligations are less onerous. This trend imposes greater responsibilities on the courts to ensure that the rights of minority or non-consenting shareholders are properly respected. It appears that the commercial court judges are knowledgeable and skilled in the requisite areas.</p> <p>ASIC is sensitive to the need to be alert for new financing techniques which may have the effect of reducing the accuracy and timeliness of information that shareholders receive and has a policy of setting out its position publicly. A recent development has been the use of equity swaps which in some cases appear to have the effect of enabling a party who would normally have to declare a substantial holding at the 5 percent threshold in a listed company to delay disclosure until 10 percent or higher. Similarly, ASIC intends to monitor progress in the ASX's proposal to permit listed companies with a capital of less than A\$300 million to raise an additional 25 percent of capital (rather than the current 15 percent limit) without shareholder approval and at a</p>

	substantial discount to the current market price.
Principle 18.	Accounting standards used by issuers to prepare financial statements should be of a high and internationally acceptable quality.
Description	<p>There is no specific requirement under Australian law for public offering documents to include audited financial statements. However, the “reasonable investor” test in s710 CA that a prospectus must contain all the information that investors and their professional advisers would reasonably require to make an informed assessment (of the investment) means that such statements are provided. ASIC would place a stop order on a prospectus that did not do so, thereby preventing the raising of funds under the prospectus.</p> <p>Similarly there is no requirement in the CA for an issuer to provide a cash flow statement. However, an entity seeking to list equity on ASX must satisfy either a profit test or assets test. In order to satisfy the profit test, the entity must provide ASX with audited accounts (statement of financial position/balance sheet, statement of comprehensive income, statement of changes in equity/retained earnings, statement of cash flows, notes) for the last three full financial years with audit reports. In order to satisfy the assets test, the entity must provide the ASX with audited or unaudited accounts for the last three full financial years with any audit reports. For both the profit and assets tests, a pro-forma balance sheet, reviewed by a registered company auditor, may also be required.</p> <p>Financial statements are prepared in accordance with a comprehensive body of accounting standards, which follow the IFRS. The organization responsible for the establishment and timely interpretation of accounting standards is the Australian Accounting Standards Board (AASB). The AASB was established pursuant to the ASIC Act. Its functions as set out in the law include:</p> <ul style="list-style-type: none"> • The development of a conceptual framework for the purpose of evaluating proposed accounting standards and international standards; • The making of accounting standards for the purposes of the CA and for other purposes; and • The participation in, and contribution to, the development of a single set of accounting standards for world-wide use. <p>The major objectives of the AASB with respect to standard-setting are to:</p> <ul style="list-style-type: none"> • Issue Australian versions of IASB documents; • Produce standards that treat like transactions consistently; • Significantly influence the development of IFRS; • Identify areas requiring fundamental review and introduce standards to cover those areas; and • Promote globally consistent application and interpretation of accounting standards. <p>The AASB has the role of providing timely guidance on urgent financial reporting issues, including issuing Australian equivalent versions of interpretations made by the International Financial Reporting Standards Interpretations Committee. . The IFRS Interpretations Committee (formerly the International Financial Reporting Interpretations Committee) is the interpretive body of the IASB whose role is to issue interpretations of IFRS. The AASB is accountable to the Minister and the Financial Reporting Council (FRC) (see Principle 19). Australian accounting standards are comprehensive and fully IFRS compliant.</p> <p>AASB 101 governs the presentation of financial statements in Australia. This accounting standard is equivalent to IAS 1 - Presentation of Financial Statements. The CA requires financial statements to comply with accounting standards and present a</p>

true and fair view.

The AASB Framework to the Preparation and Presentation of Financial Statements incorporates the Framework to the Preparation and Presentation of Financial Statements as issued by the IASB. The Framework states that investors are one group of users of financial statements. As they are providers of risk capital to an entity, the provision of financial statements that meet their needs will also meet most of the needs of other users that financial statements can satisfy.

The accounting standards are drawn up to meet the objective stated in the Framework. Financial statements must be prepared in accordance with the recognition and measurement requirements of the accounting standards. An entity can only change its accounting policy as required by an Australian accounting standard or if doing so results in financial statements presenting reliable and more relevant information about the effects of transactions, other events or conditions on the entity's financial position, financial performance or cash.

The overall objective of AASB 101 (which is the same as IAS 1) is to ensure comparability both with the entity's financial reports of previous periods and with the financial reports of other entities. AASB 101 states that the presentation and classification of items in one financial report shall be maintained for other periods unless it would be more appropriate to treat a significant change in an alternate way having regard to other accounting standards, or the accounting standards require such a change. Where an accounting policy is applied retrospectively or a retrospective restatement is made or an item is reclassified in the financial statements, a statement of financial position at the beginning of the earliest comparative period is required. Paragraphs 19 to 27 of AASB 108 generally require the retrospective application of changes in accounting policies

The AASB's processes are open and transparent:

- The AASB publishes AASB Policies and Processes which outlines how the AASB carries out its functions; Methods for public/stakeholder consultation include:
 - publishing documents for public comments (e.g., discussion papers, exposure drafts etc.);
 - roundtable discussions; and
 - consultative groups;
- If the AASB holds a meeting that, in whole or part, concerns the contents of accounting standards or international accounting standards, including interpretations of accounting standards, the meeting or that part of it must be held in public.

Surveillance and sanctions

ASIC is the regulator for the purposes of the CA, including its financial reporting requirements. Financial reports are lodged with ASIC and ASIC has powers to mandatorily obtain information and explanations under the ASIC Act. ASIC's Financial Reporting and Audit team is responsible for conducting surveillance of financial reporting activities, including compliance with accounting standards. If ASIC's surveillance activities uncover an issue with a company's financial report, ASIC will generally request that the company amends its report to address the issue. Of the 495 financial reports reviewed in 2010—2011, material changes to financial reports were made by 16 listed entities as a result of ASIC's surveillance activities. ASIC may also bring civil or criminal proceedings against directors for contraventions of financial reporting requirements of the CA. Where a director fails to take all reasonable steps to comply with or secure compliance with the requirements of accounting standards and any other financial reporting provisions in the CA, a director of a company, registered managed investment scheme or disclosing entity may commit an offence. If the

	<p>contravention is dishonest, a director may face a penalty of up to A\$220,000 or imprisonment for five years or both.</p> <p>Cross border issues</p> <p>Foreign companies that offer securities in Australia need to comply with the prospectus provisions in the CA unless an exemption applies. As described in Principle 16 there are significant trans-Tasman cross border offerings facilitated by the mutual recognition scheme for securities offerings between Australia and New Zealand. New Zealand entities listed in Australia lodge financial reports in accordance with New Zealand standards. These standards are acceptable for public offering and listing particulars documents.</p> <p>Foreign companies registered in Australia are required to lodge with ASIC annually copies of their balance sheet, profit and loss statement and cash flow statement together with any other documents required to be prepared in their country of origin for the latest financial year. Like Australian listed entities, New Zealand listed entities are required to comply with accounting standards that are consistent with IFRS in their financial reports. If ASIC believes that a financial report in accordance with the law in the entity's place of origin does not sufficiently disclose the financial position, ASIC has the power to require such companies to lodge audited or unaudited financial statements in such form and containing such particulars as it requires, which includes compliance with Australian accounting standards.</p>
Assessment	Fully Implemented
Comments	ASIC's role in the oversight of financial reporting and auditing requirements is limited to regulating compliance with the requirements for entities subject to the CA, and providing relief from them in certain circumstances.
Principles for Auditors, Credit Ratings Agencies, and Other Information Service Providers	
Principle 19.	Auditors should be subject to adequate levels of oversight.
Description	<p>ASIC is the body responsible for public interest auditor oversight, both in substance and in practice as set out in the ASIC Act and the CA. A person may be registered by ASIC as an auditor if:</p> <ul style="list-style-type: none"> • He/she is appropriately qualified; • He/she has satisfied all of the components of an auditing competency standard approved by ASIC or has specified minimum hours of suitable practical experience in auditing; and • ASIC is satisfied that the applicant can perform the duties of an auditor and is a fit and proper person to be registered as an auditor. <p>The Australian professional bodies also require their members to undertake a specific amount and type of continuing professional development. A company may also register with ASIC as an Authorized Audit Company (AAC). ASIC may impose conditions on the registration which include maintaining a specified level of professional indemnity insurance, implementing complaints handling procedures that meet Australian standards and directors executing a pro forma deed in favor of ASIC in which they undertake to use best endeavors to ensure that the AAC maintains run-off cover for a minimum of 7 years after it ceases to be registered.</p> <p>ASIC's powers include investigation, inspection and information gathering in relation to auditors and audit practices. If as a result of an inspection, surveillance or investigation ASIC considers that an auditor's conduct has been deficient or the auditor may have committed an offence under the CA, it has powers to take a number of regulatory actions, including:</p>

- making an application to the CALDB (see below) The CALDB can make orders to suspend or cancel an auditor's registration.;
- accepting an enforceable undertaking from the auditor;
- commencing prosecution or civil proceedings against the auditor; and
- imposing additional registration conditions or varying or revoking existing conditions.

Penalties for contraventions of the CA requirements range from monetary penalties of A\$2,750–A\$5,500, six months imprisonment, or both.

ASIC's Financial Reporting and Audit team is responsible for carrying out the inspections and surveillance of auditors and audit practice, and where necessary initiating enforcement action. It employs 11 professionally qualified staff members to undertake audit inspections. The results of ASIC's oversight of the audit profession through its inspection program are made public via the publication of regular omnibus reports (on a no-names basis). The outcomes of CALDB decisions, enforceable undertakings and court proceeding against an auditor are generally made public at the conclusion of the matter. However, the imposition of conditions on an auditor's registration is confidential.

The inspection program includes each of the 'Big Four' audit firms, nine second-tier audit firms and 20 smaller audit firms. Collectively, the Big Four firms audit approximately 83 percent of the entities listed on the ASX (listed entities) by market capitalization and the second tier firms audit 4 percent of the listed entities by market capitalization. ASIC inspects the Big Four firms over an 18-month cycle. The nine second-tier firms have been subject to an ASIC inspection at least once, with the majority being inspected twice. The 20 smaller firms that audit a limited number of listed entities have been inspected at least once. In the 2010-2011 financial year, 75 audit files were reviewed in the audit inspections of 11 firms. In case of deficiencies, these reviews mostly result in the audit firms committing to improve their processes. Separately, 18 audit surveillances were undertaken, and in one matter an enforceable undertaking was provided. In addition, three of the surveillance matters resulted in ASIC imposing license conditions on the auditors, mainly additional education and peer reviews of some of their future audits.

As described in Principle 20, as part of ASIC's inspection program, the independence processes and systems of the audit firms are reviewed and tested in detail to ensure legislative and professional independence requirements are met by the firm and the registered company auditor. ASIC also reviews the audit firm's processes for providing non-audit services to ensure they comply with the independence requirements contained in the professional ethical standards. In addition, ASIC undertakes reviews of the annual statements provided to it by registered company auditors to identify any potential non-compliance with independence requirements.

Other bodies involved in the process of maintaining high audit standards are:

- Auditing and Assurance Standards Board (AUASB) is an independent government body responsible for setting Australian audit and assurance standards. Since April 2006, the AUASB has released Australian Auditing Standards based on the standards issued by the International Auditing and Assurance Standards Board (IAASB).
- Financial Reporting Council (FRC) is a government body responsible for providing broad oversight of the process for setting auditing standards as well as monitoring the effectiveness of auditor independence requirements in Australia.
- Companies Auditors and Liquidators Disciplinary Board (CALDB) is an independent government body tasked with conducting hearings to determine whether the registration of a company auditor should be cancelled or suspended. ASIC or

	<p>APRA can make an application to the CALDB for a registered auditor or liquidator to be disciplined by the CALDB. The CALDB can make orders to suspend or cancel an auditor's registration or require an undertaking.</p> <ul style="list-style-type: none"> Accounting Professional and Ethical Standards Board (APESB) is funded by the Australian professional bodies, which appoint the board members. Members of the Australian professional bodies are required to comply with the code of ethics and professional standards made by the APESB.
Assessment	Fully Implemented
Comments	<p>ASIC has significant powers of investigation, inspection and information gathering in relation to auditors and audit practices which it exercises in a coherent and consistent manner.</p> <p>ASIC is conscious of the risks that can arise to the quality of audit due to the competitive nature of the audit profession. This is a global phenomenon. The CA requires companies to pay "reasonable fees" and ASIC has a public policy of monitoring companies where significant reductions in fees have occurred in order to satisfy itself that there has been no reduction in auditing standards and to send the appropriate message to the industry.</p>
Principle 20.	Auditors should be independent of the issuing entity that they audit.
Description	<p>There are extensive statutory, administrative and professional requirements in relation to auditor independence and ethical standards found in the CA, Australian Auditing Standard (ASA) 102 and 220, APES 110, ASQC 1 and APES 320. The Australian Auditing Standards are consistent with International Standards on Auditing (ISA), APES 110 is consistent with the International Ethical Code, and ASCQ1 and APES 320 are consistent with the International Quality Control Standard. The CA includes both a general independence requirement and specific independence requirements relating to business, employment, and financial relationships as well as numerous offences for contraventions of these requirements by auditors and audit firms. Auditing standards have the force of law and also give APES 110 the force of law.</p> <p>Under the general requirement for auditor independence in the CA there are extensive provisions for recognizing and dealing with conflicts of interest by auditors and audit firms. A conflict of interest is deemed to exist when the auditor is not capable of exercising objective and impartial judgment in relation to the conduct of the audit. An auditor is also prohibited from continuing to engage in audit activity if certain relationships arise between persons related to the auditor and the audited body. There are also several other provisions that outline special rules for retiring auditors after they have ceased employment with the audit company. The lead audit partner and review partner for a listed company or scheme must rotate off after 5 years and there is a 2-year cooling-off period.</p> <p>The auditor must give the directors of the audited entity an independence declaration. The independence declaration must state that there have been no contraventions of the auditor independence requirements or the applicable code of conduct, or list all of the contraventions. There are numerous specific restrictions on auditors in relation to the types of financial, business or other relationships they have with an entity they audit consistent with international standards. In addition, APES 110 sets out the fundamental principles of professional ethics (including independence) that an auditor is required to comply with. APES 110 explains that threats may be created by a broad range of relationships and circumstances and that the impact of such threats could compromise, or could be perceived to compromise, an auditor's compliance with the fundamental principles for independence. APES 110 describes in detail the threats itemized under this principle and the circumstances under which they might arise; namely self-interest, self-review, advocacy, familiarity and intimidation and sets out the necessary</p>

	<p>procedures that auditors should adopt to mitigate or eliminate the threats. ASA 102 provides APES 110 with legal backing in respect of CA audits. APES 110 also contains specific paragraphs that prohibit auditors from providing many non-audit services to audit clients.</p> <p>As regards internal systems, governance arrangements and processes for monitoring, identifying and addressing threats to independence ASQC1 requires an audit firm to establish policies and procedures designed to provide it with reasonable assurance that the firm, its personnel and others subject to independence requirements maintain independence where required by relevant ethical requirements, laws and regulations and sets out the elements which must be present in the systems. ASIC examines such systems as part of its annual inspection program.</p> <p>Public issuers</p> <p>The auditor of a public company must provide an independence declaration. The annual and half year directors' report must include a copy of the auditor's declaration. In addition, the concepts of independence of mind and independence in appearance are defined in APES 110. Other means to secure independence and integrity in financial reporting include the mandatory requirement for the top 500 listed companies in Australia to have an audit committee. Where a public company has established an audit committee it is considered best practice for the audit committee to oversee the processes for appointing the auditor and maintaining the independence of the auditor (as set out in the ASX Principles of Good Corporate Governance); the appointment of the auditor is ultimately approved by the shareholders of the company. ASX Listing Rule 4.10 requires all listed companies to provide a statement in their annual report disclosing the extent to which they have followed the ASX Corporate Governance Council's Best Practice Recommendations.</p> <p>It is also recommended that the audit committee consist of only non-executive directors, a majority of independent directors, an independent chairperson, and at least three members. If an audit committee is not established the Principles require a company to disclose how its alternative approach assures the integrity of the financial statements of the company and the independence of the external auditor, and why an audit committee is not considered appropriate. Notification, including to ASIC, is required in relation to resignation, removal or replacement of an external auditor. Furthermore, an auditor must notify ASIC as soon as practicable (but within 28 days) where the auditor has reasonable grounds to suspect contravention of the CA, which includes contraventions of the auditors' independence requirements and modifications to the auditors' reports.</p> <p>Sanctions</p> <p>ASIC has a range of actions available in relation to non-compliance with independence requirements including authority to initiate or commence and carry out criminal or civil proceedings against an auditor or an audit firm. ASIC also has the power to refuse to register or receive a document if it is of the opinion that a document submitted contains matters contrary to the law, contains information that is false or misleading etc.</p>
Assessment	Fully Implemented
Comments	Although Australia, unlike some jurisdictions, does not impose a total ban on auditors and audit companies carrying out non-audit business with an audit client, the constraints are extensive and well defined and are consistent with international norms.
Principle 21.	Audit standards should be of a high and internationally acceptable quality.
Description	A financial statement that is to be included in public offering and listing particulars documents and publicly available annual reports must be prepared in accordance with the CA and must be audited in accordance with Australian Auditing Standards. The

	<p>AUASB is responsible for the setting of auditing standards in Australia. Since 2005 the AUASB has operated under a strategic direction from the FRC to develop Australian Auditing Standards that have a clear public interest focus and are of the highest quality and to use, as appropriate, International Standards on Auditing (ISA) of the IAASB as a base from which to develop Australian Auditing Standards. The AUASB has therefore revised and redrafted the Australian Auditing Standards, using the equivalent ISA as the underlying standard, thereby ensuring conformity with international auditing standards. These auditing standards apply to reporting periods commencing on or after 1 January 2010.</p> <p>The AUASB is accountable to the Minister and the FRC. The Minister appoints the Chair of the AUASB and the FRC appoints other members. The Minister also appoints the members of the FRC. Current members of the FRC include an ASIC Commissioner, the Chairman of the AUASB, the Chairman of the Australian Accounting Standards Board (AASB), three partners from accounting firms, executives of five Commonwealth and State government departments, three company directors, and four executives of companies or associations. The FRC must give the Minister a report each year on the operations of the AUASB and its committees, advisory panels and consultative groups.</p> <p>The AUASB carries out its function of making auditing standards through an open and consultative process (including seeking submissions on exposure drafts, consultation meetings with stakeholders, and meeting in public). When a technical issue has been identified it is added to the AUASB's agenda which invites submissions and other input from stakeholders. The AUASB considers this input in making submissions to the IAASB and in developing auditing standards. The AUASB also has an annual AUASB Consultative Meeting that brings together a cross-section of interest groups to increase their involvement in the standard-setting process.</p>
Assessment	Fully Implemented
Comments	<p>Since April 2006, the AUASB has released Australian Auditing Standards based on the standards issued by the International Auditing and Assurance Standards Board (IAASB). The AUASB also has the ability to modify the text of the international auditing standards to the extent necessary to take account of the Australian specific legal or institutional environment (s227B(4) ASIC Act).</p>
Principle 22.	<p>Credit rating agencies should be subject to adequate levels of oversight. The regulatory system should ensure that credit rating agencies whose ratings are used for regulatory purposes are subject to registration and ongoing supervision.</p>
Description	<p>Since 1 January 2010, CRAs have been required to hold an AFSL and are therefore subject to all ASIC's supervision and enforcement powers (as set out in Principles 10-12 without exception, including powers to suspend or revoke the AFSL of a CRA). They are also subject to a number of CRA-specific license obligations. The key specific obligations for CRAs are that they adopt, publish and adhere to a code of conduct that complies with the IOSCO Code of Conduct Fundamentals for Credit Rating Agencies, and report to ASIC annually on their compliance with this code. Six CRAs operate in Australia. The three large global CRAs (Standard and Poor's ('S&P'), Moody's, and Fitch Ratings ('Fitch')) dominate the wholesale markets. The team within ASIC which is responsible for regulating CRAs is the Investment Banks (IB) stakeholder team which also regulates investment banks, hedge funds and retail OTC derivatives issuers.</p> <p>In Australia, CRAs that carry on a business of providing credit ratings on financial product must hold an AFSL irrespective of whether the ratings will be used for regulatory purposes. The AFSL requirement applies because credit ratings constitute financial product advice under the CA. AFSLs granted to CRAs define 'credit rating' as 'a statement, opinion or research dealing with: (a) the creditworthiness of a body; or (b) the ability of an issuer of a financial product to meet its obligations under the financial product'. Because of the AFSL requirement and the definition of 'credit rating',</p>

there is no need to define 'credit rating agency' under Australian law. CRAs have to comply with all ASIC's information requirements just as any other applicant for an AFSL. ASIC has not issued any specific guidance for AFSL applications by CRAs. Because of the additional requirements that apply to a holder of an AFSL for retail business, such as PI insurance and membership of a retail dispute resolution scheme, and ASICs' refusal to grant relief from these requirements, five of the six CRAs which have sought and obtained licenses have opted for wholesale licenses. This however requires 'wholesale' CRAs not to issue their ratings to retail investors, to limit access to retail investors to their websites and to refuse consent to, for example, an issuer including a rating in a prospectus for the offer to the public of securities.

In the case of the global firms, ASIC has taken the view that its regulatory focus should not be on where the analyst is located but which entity provides the financial service of providing the credit rating, that is the Australian entity which is subject to direct oversight by ASIC. All three also rate Australian companies from their offices in Australia. ASIC's powers include mandatory periodic reporting, mandatory breach reporting and compulsory notice powers. CRAs are required to comply with all elements of the IOSCO Code of Conduct Fundamentals for Credit rating Agencies. ASIC has replaced all references in the IOSCO Code to 'should' with 'must' (subject to a small number of carve-outs that have been made optional measures where it is impractical for CRAs operating in Australia to comply). In addition to complying with the IOSCO Code CRAs must ensure their credit analysts are trained and competent to be involved in the preparation of credit ratings. CRAs in Australia have specific license conditions relating to the training of their representatives.

The CRA licensing program began on January 1 2010. ASIC's requirements for the mandatory Annual Compliance Reports were finalized late 2011 and the first completed reports have been received. The Annual Compliance Report must be lodged with a CRA's balance sheet as required by the CA for any period of time that ASIC requests by the date ASIC reasonably requests in writing. The Annual Compliance Report delivers to ASIC a narrative explanation of measures designed by a CRA to ensure compliance with its obligations under each heading of the IOSCO Code and CRA licence conditions such as the monitoring of ratings and training requirements. The Annual Compliance Report assists ASIC's independent assessment of CRA compliance with obligations concerning quality and integrity of CRAs' rating processes, conflicts of interest and responsibilities to the investing public and issuers. ASIC has conducted four on-site inspections to verify these Reports. Like other AFSL holders CRAs are also subject to mandatory breach reporting to ASIC.

In 2010 ASIC sought information from the CRAs concerning their compliance with the requirement for independent assessment of staff training programs as required in the AFSL and in 2011 on the preparation and timely announcement of ratings. ASIC has conducted reactive surveillances in response to complaints about failures by 'wholesale' CRAs to prevent third parties from disclosing ratings to retail investors and one complaint concerning a misleading media release. ASIC also uses a risk assessment approach based on risk mapping using probability of occurrence and impact upon occurrence. All identified risks rated 'high' will be escalated for immediate action. As CRAs are required to comply with all elements of the IOSCO Code, ASIC's oversight addresses all detailed requirements of the three sections of the Code Fundamentals, namely:

- The Quality and Integrity of the Rating Process;
- CRA Independence and the Avoidance of Conflicts of Interest; and
- CRA Responsibilities to the Investing Public and Issuers.

CRAs which fail to ensure they have a reasonable basis for their ratings may be subject to sanctions for engaging in misleading or deceptive conduct or making false or

	misleading statements in relation to financial services and products.
Assessment	Fully Implemented
Comments	<p>ASIC has acted in a timely and comprehensive manner to implement the IOSCO Code and to impose a supervisory program on the CRAs doing business in Australia. The European Securities and Markets Authority (ESMA) announced in April 2012 that, after detailed examination, it has assessed the Australian legal and supervisory framework for credit rating agencies as being equivalent to the EU regulatory regime for credit rating agencies, alongside the regimes in the US and Canada.</p> <p>The attempt to prevent retail investors from accessing CRA ratings because five of the six CRAs have opted for 'wholesale only' licenses is likely to prove ineffective in practice because of the way ratings are made public and generally circulated throughout the market and in the press and social media. ASIC has already had to conduct reactive surveillance in response to complaints about failures by 'wholesale' CRAs to prevent third parties from disclosing ratings to retail investors.</p>
Principle 23.	Other entities that offer investors analytical or evaluative services should be subject to oversight and regulation appropriate to the impact their activities have on the market or the degree to which the regulatory system relies on them.
Description	<p>Regulatory framework for research report providers</p> <p>Research report providers are required to be licensed as general advice providers (see Principle 29) under the AFSL regime and are therefore subject to the requirements applicable to all AFSL holders, including the requirement to provide their services efficiently, honestly and fairly (s912A CA). There is no regulatory distinction between sell-side, buy-side and independent research report providers.</p> <p>ASIC has the power to take action against inappropriate practices in the research industry, although it has not done so to date. However, it has periodically considered its regulatory settings concerning providers of research reports. For example, the conflicts management obligation introduced as part of the Corporate Law Economic Reform Program was introduced by the Australian Parliament as a reaction to ASIC's surveillance activities on the securities research industry in 2003 (Report 24, Research Analyst Independence). To support this new obligation, ASIC published RG 181 (Licensing: Managing conflicts of interest) in 2004 and additional guidance particularly addressed for this sector later in 2004 (RG 79, Managing conflicts of interest: An ASIC guide for research report providers).</p> <p>Conflicts of interest</p> <p>RG 79 contains detailed guidance on how research report providers should manage (including disclose and, where necessary, avoid) conflicts of interest. It covers ASIC's expectations on the arrangements research report providers should have in place, including a policy on trading restrictions at both the analyst and firm level. In particular, RG 79 requires a research report provider to ensure that any conflicts of interest arising from its or its staff's material interest in a product researched by it does not result in a failure to comply with its duties as a licensee or in the integrity of the advice being compromised.</p> <p>Further, in relation to trading ahead of distribution, RG 79 requires care to be taken where the research report provider or its research staff trade in a financial product before (or shortly after) the research report provider broadly distributed a research report about that product. It further encourages a research report provider to consider imposing a "quiet period" on itself and/or its research staff or adopting robust information barriers that ensure that trading staff are not aware of pending research.</p> <p>RG 79 requires research report providers to have a policy on how and when non-</p>

	<p>research services are provided to an issuer for whom the research report provider also produces research. In particular, the guide states that research report providers will need to consider, among other measures, whether they should ensure that research on a product issuer is not published while non-research services are being provided to it, and for a short period afterwards, and/or whether they should fully disclose in relevant research reports the nature of any non-research services provided to a product issuer.</p> <p>Generally, ASIC expects research report providers to ensure that their research staff are structurally and physically separated from (and are not supervised by) any staff that are performing an investment banking, corporate advisory, or dealing function. Decisions about the remuneration of research staff should not be made by staff directly connected with another business unit.</p> <p>Compliance systems and senior management responsibility</p> <p>RG 79 requires research report providers to maintain specific policies and procedures for managing conflicts of interest, and to make these available to all staff. It also requires procedures to eliminate or manage the undue influence of issuers, institutional investors and other outside parties upon analysts. Among others, it requires that research reports must be based on objective, verifiable facts and analysis, and not on the special interests of the research report provider's research staff, the product issuer or others. Further, research report providers should ensure that research reports or information about their contents are not communicated outside the research report provider before the report is provided to clients in the normal course of business. Research report providers should take reasonable steps to ensure that end-users have access to disclosures of actual and potential conflicts of interest.</p> <p>Other providers of analytical or evaluative services</p> <p>ASIC has published two RGs addressed to experts in March 2011 (RG 111: Content of Expert Reports and RG 112: Independence of Experts). These relate to the fact that the CA and the ASX Rules require in some cases the commissioning of an independent expert report. This may also be done voluntarily. The purpose of the expert reports is to assist security holders to make an informed choice in relation to a takeover bid, compulsory acquisition and buy-out, scheme of arrangement, related party transaction and capital reorganization. While the first RG expresses ASIC's views on how experts should conduct their analysis and what valuation methodologies they should use, the second RG focuses on the need for an expert to be independent and how his/her independence might be affected by a previous/existing relationship with the commissioning and other interested parties.</p> <p>Periodic evaluation of the need for regulation</p> <p>ASIC continues to develop its thinking on research report providers. It recently published CP 171 on updating RG 79. The consultation period closed in February 2012 and ASIC is now reviewing submissions.</p> <p>Besides taking measures in the above mentioned fields, ASIC is also currently considering the need for any possible regulatory measures on the comparison websites for financial services.</p>
Assessment	Fully Implemented
Comments	
Principles for Collective Investment Schemes	
Principle 24.	The regulatory system should set standards for the eligibility, governance, organization and operational conduct of those who wish to market or operate a collective investment scheme.

Description	<p>Overview of the Australian regulatory framework for CIS and their operators</p> <p>In Australia, CIS are referred to as Managed Investment Schemes (MIS). The statutory definition of MIS is very broad. It refers to a scheme in which investors acquire interests through contributions which are pooled to produce financial or proprietary benefits to the scheme's members. The members do not have day-to-day control over the operation of the scheme. Some MIS fall outside the scope of the IOSCO Principles; as an example, time-sharing schemes are also MIS. For tax reasons most MIS take the form of unit trusts.</p> <p>The regulatory framework for MIS is set out in Chapter 5C of the CA supported by various ASIC RGs. Australia's regulatory regime draws a distinction between MIS according to whether they are marketed to retail clients⁶ (Retail MIS) or wholesale clients⁷ (Wholesale MIS). This is based on the assumption that wholesale clients do not require the same level of protection as retail clients because they are considered to be better able to assess the risk involved in financial transactions.</p> <p>Registration/authorization requirements</p> <p><i>MIS</i></p> <p>A Wholesale MIS does not need to be registered. Under s601ED CA, a Retail MIS is required to be registered if it has more than 20 members (or if it is related to other MIS, 20 members in aggregate with all such MIS) or it is promoted by a professional promoter. Operating a Retail MIS without registering it is an offence punishable by fines and/or imprisonment.</p> <p>ASIC is required to register a Retail MIS within 14 days of receiving an application, unless one of the criteria for refusing an application specified in the CA applies. The REs of Retail MIS must ensure that there is a compliance plan for each MIS (s601FC(1)(g) CA). ASIC can refuse an application for registration when, among other things, the MIS's constitution does not meet the requirements of s601GA and s601GB CA or when the MIS's compliance plan does not include all the issues required under s601HA CA. ASIC generally reviews the constitutions of all Retail MIS for which an application for registration is filed.</p> <p>The regulatory framework draws a further distinction between those registered MIS that are disclosing entities and those that are not. A disclosing entity is any listed MIS or a MIS that issued interests under a PDS with at least 100 members. Most registered MIS are within the CA definition of disclosing entity. They are subject to additional disclosure requirements (see Principle 26).</p> <p><i>Operating/marketing a MIS</i></p>
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⁶Under the CA, a client is treated as a 'retail client' unless specifically designated a wholesale client.

⁷A person will be considered a wholesale client only where:

- the price of the financial product or service provided exceeds \$500,000 (this amount can be varied in certain circumstances);
- it is a business above a certain size, that is, it is not a small business;
- the person provides evidence of a nominated level of personal wealth (personal assets of at least \$2.5 million or gross income of at least \$250,000 a year for the last two years); or
- the person is a:
 - 'professional investor' (for example, AFSL holders, banks, superannuation fund trustees, listed companies or investment companies); or
 - 'sophisticated investor' – where the client's previous experience allows the client to assess the merits, values and risks of the service.

The operator of a MIS, whether Retail or Wholesale, must hold an AFSL (for dealing, providing financial advice and providing custodial services, see Principle 29). In addition, the operator of a registered Retail MIS, referred to as the Responsible Entity (RE), is subject to additional requirements set out in Chapter 5C of the CA. An RE's AFSL must specify the registered MIS that it is authorized to operate, unless it can demonstrate that it has the organizational competence and capacity to operate MIS of a particular asset kind.

The conditions for ASIC granting an AFSL are described under Principle 29. The CA also sets out other more detailed requirements for REs that relate in particular to the need to act in the best interest of members and not to make use of information acquired to gain improper advantages. Further, an RE of a Retail MIS is subject to additional financial requirements compared to the basic requirements for all AFSL holders (see Principle 30). However, these financial requirements do not apply if the RE is a body regulated by APRA, which are currently subject to the financial requirements of RSEs (see Table 2).

The requirement to hold an AFSL also applies to a person that markets a MIS. It is also possible for a person to market a MIS as an authorized representative of an AFSL holder, in which case the latter remains liable for the conduct of the representative. The same principle applies where the functions of an RE are outsourced or delegated.

33 REs are currently regulated by APRA, in which case some of the AFSL requirements do not apply because APRA's requirements are presumed to be sufficient (see Principle 1 and Section IV).

Exemptions for foreign CIS

ASIC has issued a class order relief that exempts operators of certain foreign collective investment schemes (FCIS) from the need to hold an AFSL and from the need to register the FCIS under Chapter 5C CA. The exemption is based on:

- regulation by the overseas regulatory authority of the FCIS being sufficiently equivalent to regulation by ASIC (from an investor protection, market integrity, and systemic risk perspective);
- effective cooperation arrangements existing between the overseas regulatory authority and ASIC;
- adequate rights and remedies being practically available to Australian investors for breaches of the overseas regulator's provisions; and
- the FCIS not principally targeting Australian investors or sourcing more than 30 percent of the value of investments in the FCIS from Australian investors.

This class order relief is currently available for operators of certain FCIS regulated in the U.S., New Zealand, Hong Kong, Singapore, and Jersey. Exemptions can also be granted to foreign financial services providers that market CIS in Australia on the basis of largely similar criteria.

Supervision and ongoing monitoring

There is no regular reporting to ASIC by the REs, operators of Wholesale MIS or the MIS themselves beyond the yearly and possible half-yearly financial and directors' reports (see Principle 26) and the requirement to provide ASIC with a copy of the auditors' reports (both on the financial and compliance plan audits). ASIC monitors those reports on a risk assessment basis. Yearly reports by compliance plan auditors are an important tool in this respect, since ASIC reviews and follows up on any qualified audit reports.

The staff of the Investment Management and Superannuation stakeholder team amounts to 44; approximately 75 percent of them work on MIS related matters, with 14 persons being in charge of surveillance activities. Considering the significant amount of registered MIS (4,500), registering schemes and granting relief require a significant

<p>amount of resources.</p> <p>ASIC uses a risk assessment framework to target REs for surveillance. Targeting is primarily driven by the types of issues it is looking to test or assess in the market and the types of products involved. This is drawn from an identification of the compliance risks involved and the potential likelihood and consequences of the risks across the market. Although of less significance, surveillance can also focus on the entities that ASIC considers being of higher risk.</p> <p>Selection criteria for surveillance projects include whether the surveillance:</p> <ul style="list-style-type: none"> • Will help gather information about products, sectors, participants or possible risks; • Addresses concerns with compliance arising from e.g., breach reports relating to the sector; • Addresses concerns in relation to distressed sectors or participants; and • Will inform policy change. <p>ASIC's on-site surveillance can focus on particular sectors (e.g., ETFs, MMFs) or look at a particular topic across a broader set of supervised entities (e.g., risk management). In 2011-2012, ASIC's on-site surveillance covered:</p> <ul style="list-style-type: none"> • Exchange traded funds as part of a review of the compliance arrangements of REs; • Compliance plan auditors as part of a review of the audit processes for compliance plan auditors; and • Risk management processes as part of a review of the adequacy of risk management arrangements. <p>However, ASIC considers that in most cases it is not necessary to perform on-site surveillance due to its extensive powers to serve notices requiring the production of books and records which facilitates desk-based surveillance. Its desk-surveillance activities can also be of "high intensity", which is surveillance that involves more than two business days of work but is primarily conducted off-site through meetings, phone calls, desk-based research and document review.</p> <p>During the same period, desk-based high intensity surveillance covered:</p> <ul style="list-style-type: none"> • Cash management funds (money market funds) as part of a review of operational activities and compliance arrangements of REs for cash management funds; • Agribusiness funds as part of a review of compliance by REs for agribusiness schemes with ASIC's disclosure guidance for PDSs for agribusiness schemes; • Unlisted property trusts as part of a review of compliance by REs for unlisted property trusts with ASIC's disclosure guidance for PDSs for unlisted property trusts; <p>According to ASIC, the predominance of desk-based surveillance reflects the legislative structure which envisages that compliance plan auditors are required to directly and regularly assess compliance arrangements. Overall, 88/585 REs were subject to either on-site surveillance or desk-based high intensity surveillance in 2011/12. The fact that many REs are subject to the supervision of both ASIC and APRA requires ASIC to cooperate with APRA in its surveillance activities, in particular if they relate to areas that fall under APRA's responsibility under the CA (e.g., risk management). However, from APRA's perspective on-site inspections relating only to securities business are seldom relevant, which might lead to different supervisory treatment of REs depending on whether they are APRA regulated bodies or not. Considering that some Retail MIS are managed by APRA regulated bodies, this raises some questions about the consistency of supervision for substantially the same type of business.</p> <p>All AFSL holders need to notify ASIC of any change in the responsible managers named on the AFSL within 10 business days and of a change of control of the RE. The</p>

	<p>constitutions of the REs and registered MIS and any amendments to them have to also be lodged with ASIC.</p> <p>Record-keeping</p> <p>AFSL holders, including REs, are subject to record-keeping obligations on their organization and business. The record-keeping requirements on the transactions in MIS assets and in MIS units/interests apply only to Retail MIS.</p> <p>Conflicts of interest and conduct of business</p> <p>AFSL holders are required to have in place adequate arrangements for the identification and management of conflicts of interest. In addition, REs of registered MIS are subject to requirements on related party transactions according to which member approval is needed for giving financial benefits to the RE or its related parties that come out of scheme property or that could endanger those interests. The REs also have the general duty to treat members of the same class of investors equally and members of a different class fairly.</p> <p>The conduct of business requirements covered by the IOSCO Principles for CIS generally applies only to registered MIS. They are covered by legislative requirements (e.g., selection of investments, related party transactions, fees), ASIC Class Orders (related party underwriting) and ASIC RG 132 which requires REs to cover certain elements of the Principles in their compliance plans (e.g., best execution, fair allocation, churning, and inducements).</p> <p>Delegation</p> <p>An AFSL holder must maintain adequate resources to carry on the financial services provided under its AFSL. However, a RE has the power to appoint an agent to do anything authorized in relation to the registered MIS, in which case it remains liable to the members for the actions or inactions of its agents. ASIC expects licensees to have appropriate arrangements for monitoring outsourced functions (RG 104.36). An AFSL holder has the power to terminate delegation and make alternative arrangements for the performance of the delegated function.</p> <p>While there are no specific disclosure requirements in relation to delegation arrangements, the identity of key delegates (i.e., the custodian, administrator and investment manager or advisor) and any unusual and significant terms of their engagement would normally be required to be disclosed in the PDS under the general disclosure obligations. If not disclosed in the PDS, the RE would need to publicly disclose information that would commonly influence investors in deciding whether to acquire the product. This would include any key investment managers and their terms of engagement.</p> <p>Where the provision of a financial service is delegated, the delegate must either hold its own AFSL or be an authorized representative of the AFSL holder. In case the delegate holds an AFSL it will be subject to a duty to have adequate arrangements to manage conflicts of interest and ASIC has the power to obtain data from it. If the delegate does not hold an AFSL, the appointing AFSL holder's duty to manage conflicts of interest and to provide ASIC with access to data (either directly or through the delegate) extends to the business being conducted by the representative as a delegate. In the event there is a failure to comply with the duty to have adequate arrangements to manage conflicts of interests, ASIC has powers to take action against the holder of the AFSL.</p>
Assessment	Partly Implemented
Comments	ASIC has limited resources for the proactive surveillance of REs and MIS. The supervisory approach seems to rely heavily on external reports, desk-based surveillance, on-site surveillance of limited scope and length, and deterrence impact of ASIC's enforcement activities. Additionally, much of the surveillance activities appear to

	<p>serve the purposes of gathering information and informing policy which, even though important in a fast developing industry, falls short of the objectives of the IOSCO Principles relating to supervision and ongoing monitoring.</p> <p>Continuing to focus on the nature and quality of proactive supervision therefore seems necessary. In this context, given the fact that many important REs are also regulated by APRA, it would be important to ensure that they are subject to similar inspections as the REs solely supervised by ASIC. Generic banking or insurance focused inspections are seldom sufficient to address the specific risks arising from asset management activities. In the current regulatory set-up, this requires agreement on the regulatory priorities between ASIC and APRA and implementation of those priorities in a consistent manner across the sector independent of the legal form of the entity conducting the activity.</p> <p>Although on the basis of the statistics collected by the Australian Bureau of Statistics the size of the wholesale fund industry is limited in Australia, the general lack of information on the nature and potential risks arising from this part of the fund management industry is a concern. The IOSCO Principles require the assessors to determine, among others, the type and complexity of CIS in the jurisdiction, the number of CIS in existence and the assets under management. This has been challenging in Australia for the Wholesale MIS, which makes it difficult to determine the measures that would be recommendable in the Australian circumstances.</p> <p>It is not uncommon in IOSCO jurisdictions that wholesale fund business is subject to a different regulatory framework than retail fund business. However, the Australian regime where this business is almost completely unregulated (beyond the generic duties of AFSL holders), does not fit well with the revised IOSCO Principles that cover hedge fund managers and/or hedge funds that in many jurisdictions are predominantly wholesale funds.⁸ As a first step, additional data on wholesale funds would assist the authorities in considering whether their managers are subject to an appropriate regulatory framework taking into account the potential risks arising from this activity. Secondly, there might be benefits in considering the advantages of introducing more systematic data collection on this part of the CIS industry to enable ASIC to monitor the development of the size and nature of the business as a basis for deciding on possible regulatory action.</p>
Principle 25.	The regulatory system should provide for rules governing the legal form and structure of collective investment schemes and the segregation and protection of client assets.
Description	<p>There are no requirements for the legal form and structure of Wholesale MIS and the following therefore applies only to registered Retail MIS.</p> <p>Legal form</p> <p>A registered MIS is normally a statutory trust, where the RE holds the scheme property on trust for the scheme members (s601FC(2) CA). Members' rights are prescribed by the constitution of the MIS and the CA. The constitution must make adequate provision for pricing, powers of the RE, complaints handling, fees and indemnities, withdrawal rights, and borrowing powers (s601GA CA). The CA sets out member rights in relation to changing the RE, changing the constitution, rights of withdrawal and rights for the winding up of a registered MIS.</p> <p>The RE of a disclosing entity must publicly disclose, on an ongoing basis, information that would commonly influence investors in deciding whether to invest in the MIS. The legal form and structure of the MIS together with associated risks would generally constitute such information. In addition, the point of sale disclosures would normally</p>

⁸As set out in the comments on Principle 28, steps have however been taken towards increasing the intensity of supervision of wholesale hedge funds.

provide information on the legal structure and form of a MIS. The constitution of a MIS is also publicly available and has to be lodged with ASIC. When registering a MIS ASIC also verifies that its constitution meets the requirements of the CA.

Investor rights

Material changes to MIS investors' rights cannot be made without the prior approval of members. Where an amendment involving changes to investors' rights is made to the constitution of a registered MIS, the RE is required to lodge a copy of the modification or new constitution with ASIC. The change in the constitution does not take effect until it is lodged with ASIC.

For rights not captured in the constitution (e.g., fees), the RE would generally be required to give notice to members of the change as a result of the MIS being a disclosing entity or as part of the RE's material change or significant event disclosure obligation (s1017B CA).

ASIC would be able to intervene in any deviations from the investment policy included in the constitution by considering that the RE would have made a misleading statement and taking appropriate enforcement action (see Principle 12 for the range of measures available).

Segregation and safekeeping of assets

The CA requires the RE to ensure that scheme property is clearly identified as such and held separately from the property of the RE or any other MIS (s601FC(1)(i) CA). This applies to the RE and to any custodian it uses (s601FB(2) CA). ASIC has issued RG 133 that provides more detailed guidance on this topic.

ASIC has issued a class order allowing a custodian to hold scheme property for several managed investment schemes in an omnibus account, but only if regular reconciliations are made and it is in the best interests of members to do so (CO 98/51: Relief from duty to separate assets of a managed investment scheme). The best interest of members requirement may be satisfied, for example, if holding property separate from the property of other schemes would increase the costs to members without providing any improved security. Conversely, mere administrative inconvenience for the custodian would not be an adequate reason. The class order does not allow the asset holder to hold scheme property and its own assets or that of the RE in the same account.

According to RG 133, scheme property must be held by a third party custodian unless the RE meets additional standards and requirements allowing it to hold scheme property itself. These include:

- The RE generally having net tangible assets of more than A\$5 million, or being an ADI (RG 166.58). These additional financial requirements are imposed as a condition on a RE's AFSL where it provides custodial services (s914A CA).
- Standards on such matters as staff capabilities and administrative arrangements (RG 133.2). Specifically, custody staff of an RE must have independent reporting lines to the board or compliance committee, not take part in investment decisions and, in some circumstances, be physically separated from other staff (RG 133.8).

The RE needs to demonstrate to ASIC when seeking a licence that it meets the above standards and requirements, or identify how it will engage an independent custodian for the purpose of holding scheme property. ASIC also requires the above standards and requirements to apply to a related party of the RE engaged to provide custody services (RG 133.29).

According to ASIC, the amount of funds that are held in custody either by the RE itself or by a related party is limited. However, no up-to-date information is available.

	<p>According to a report of the Centre for Corporate Law and Securities Regulation of the University of Melbourne from 2003 the percentage of assets held in self-custody or related party custody ranged from 23 percent for REs operating schemes investing in financial assets to 89 percent for those operating mortgage investment schemes. As to the measures ASIC undertakes to address the possible risks of custodial arrangements, it pays attention to them when reviewing the fund documentation and, where appropriate, as part of its broader surveillance activities. However, it has not undertaken any specific surveillance activities for MIS custody arrangements in the recent past.</p> <p>In case a third party custodian is used, the RE must identify the property as scheme property to any custodian as the RE is under an obligation to ensure the custodian keeps proper records identifying the scheme property (Pro Forma 209 condition 35(b)). If a custodian or sub-custodian is used, the obligation to ensure scheme property is clearly identified remains with the RE (s601FC(1)(i) CA). The scheme property is held by the RE or any custodian on trust. Therefore, it is not available to their creditors or other stakeholders (s601FB(2) CA). This also applies to sub-custodians as agents of the RE's agent (s601FB(3) CA).</p> <p>Winding up</p> <p>The registered MIS's constitution must make adequate provision for the winding up of the MIS (s601GA(1)(d) CA). ASIC considers that adequate provision has been made, if the constitution deals with all the circumstances under which a registered MIS may be wound up and provides for an independent audit by a registered company auditor of the final accounts after winding up (RG 134.24).</p> <p>A registered MIS can also be wound up by majority resolution of its members. The RE can also seek to wind up a registered MIS by following a procedure set out in the CA, if the purpose of the MIS is accomplished or cannot be accomplished. The winding up can also be ordered by a court in certain circumstances upon application by any of the persons named in the CA (Part 5C.9 CA).</p>
Assessment	Broadly Implemented
Comments	<p>Key Question 8 of the IOSCO Methodology requires that the regulatory system provides special legal and regulatory safeguards in cases where the custody function is performed by the legal entity that is also responsible for the investment function or a related entity. The Australian regulatory regime allows the RE to be in charge of all the functions relevant for fund management, i.e., administration, investment management, custody and valuation. It can also use a related party to undertake these functions.</p> <p>With regards to self-custody or related party custody, certain safeguards are in place, but they do not appear to be sufficiently stringent. This is particularly true in cases where the investment and custody functions are undertaken by the same legal entity or by related entities that share the same management. If this type of custodial arrangements continues to be allowed, the safeguards should be enhanced by, for example, requiring the custodian to hold a higher amount of capital, by introducing specific governance and operational requirements and by requiring periodic independent verification focusing on the robustness of the custodial arrangements.</p>
Principle 26.	Regulation should require disclosure, as set forth under the principles for issuers, which is necessary to evaluate the suitability of a collective investment scheme for a particular investor and the value of the investor's interest in the scheme.
Description	There are no disclosure requirements for Wholesale MIS and the following therefore applies only to registered Retail MIS. In practice the operators of wholesale funds provide an information memorandum on the fund to prospective investors.

Initial disclosure obligations

An investor must receive a Product Disclosure Statement (PDS) when purchasing interests in a registered Retail MIS. Depending on the nature of the MIS assets, the PDS can be in the format of either a Shorter PDS or a Standard PDS. A Shorter PDS can be used by a Simple MIS that invests in highly liquid assets or could liquidate 80 percent of its assets at market price within 10 days. Standard MIS are subject to the normal PDS requirements under the CA (Chapter 7.2, Division 2). The Shorter PDS regime for Simple MIS is currently being phased in and came into force for all MIS on 22 June 2012. ASIC does not have data on the current level of usage of the Simple PDS regime.

There are limited exceptions to the requirement to provide a PDS that are determined in the CA.

A Standard PDS must generally contain information that might reasonably be expected to have a material influence on the investment decision of a reasonable person as a retail client (s1013E CA). ASIC has also given guidance on specific disclosures (including on whether the fund meets certain benchmarks) required in the Standard PDS of mortgage schemes (RG 45 - Mortgage schemes: Improving disclosure for retail investors), unlisted property schemes (RG 46 - Unlisted property schemes: Improving disclosure for retail investors) and infrastructure entities (RG 231 – Infrastructure entities: Improving disclosure for retail investors).

For Shorter PDS there is no general obligation; instead, there are some broad areas on which disclosure is required. These include summaries on the interests that members acquire, on the significant features and benefits of the MIS and on the investment options offered by the MIS as well as information on certain fees and management costs for the MIS.

The publicly available information also includes the date of the PDS, the constitution of the MIS, the name and contact details of the MIS, methodology for asset valuation, procedures for purchase, redemption and pricing of MIS interests, audited financial information on the MIS, custodial arrangements, and the use of any other delegates (e.g., administrators or investment managers).

Ongoing disclosure obligations

All registered MIS must comply with their ongoing disclosure obligations. For a disclosing entity, these obligations require disclosure of information not generally available that would be likely to influence those who commonly invest in the MIS in deciding whether to acquire interests in the MIS. For a registered MIS that is not a disclosing entity, there is an obligation to notify retail clients of significant changes to information in the PDS (s1017B CA). For a Standard MIS, a supplementary PDS or a replacement PDS can be issued to correct a misleading or deceptive statement or an omission or to update information in a PDS (s1014A and 1014H CA). For a Simple MIS, a supplementary PDS cannot be issued at all and a new PDS is required (reg 7.9.11U CR).

Information on valuation

Even though there is no specific regulatory requirement, matters relevant to valuation would be considered to fall under the generic requirements for the content of a PDS. A Standard PDS is required to cover significant characteristics or features of the MIS and significant risks associated with holding an interest in the MIS (s1013D CA), whereas a Shorter PDS needs to include information on how the MIS works and the interests which investors acquire.

A large majority of registered MIS in Australia have adopted the formula based pricing

methodology for MIS units that gives discretions to the RE affecting valuation used for pricing purposes (s601GAB and 601 GAC of CO 05/260). This approach requires the RE to document the MIS's policy for pricing its units and to make it available to existing members on request. Information regarding the pricing of units is also required to be disclosed in a PDS.

Under the ongoing disclosure obligations, matters material to valuation of the MIS are required to be disclosed on a timely basis (s674, s675, s1017B CA).

Periodic reporting

All MIS must prepare an annual financial report (s292 CA). The financial report must contain financial statements for the year and the notes to the financial statements, together with the directors' declaration about the statements and notes (s295 CA). It must comply with accounting standards and regulations (s296 CA) and give a true and fair view of the financial position and performance of the MIS (s297 CA). Australia's accounting standards follow the IFRS (see Principle 18). An RE must also prepare a directors' report for each financial year (s298 CA). Information required in that report is set out in s299 CA. This includes a review of operations during the year and any significant changes in the state of the MIS during the year. All the above reports must be lodged with ASIC within three months after the end of the financial year (s319 CA).

In cases where the registered MIS is a disclosing entity, it is required to prepare a financial report and a directors' report on a half yearly basis (s302 CA). Those reports must be lodged with ASIC within 75 days after the end of the half year (s320 CA).

Within three months after the end of the financial year, a RE must send to members either copies of the financial report, directors' report and the auditor's report for the MIS, or a concise report that summarizes the other reports (s314 CA).

A RE must provide at least once a year periodic statements to existing members on the development of their investment. The statement must be given as soon as practicable and within six months after the end of the relevant reporting period (s1017D CA).

In practice, most REs publish on their websites various information on their funds, including updates on the performance of the funds.

Standard formats

The main regulatory requirement for a Standard PDS is that it has to be worded and presented in a clear, concise and effective manner (s1013C(3) CA). ASIC has also given guidance on disclosures for some fund types (see above). Under the Shorter PDS regime, regulations have been made prescribing in detail formatting requirements which have been developed from consumer testing to ensure effective communication for retail clients (Sch 10E CR).

In addition, there are separate formatting requirements for fee and cost disclosures that apply for all PDS for MIS.

There are no specific requirements for the format of non PDS disclosures beyond the general requirement that all disclosures about interests in all MIS must not be likely to mislead or deceive (s1041H CA).

Advertisements

There are a number of specific regulatory limitations on advertising set out in s1018A of the CA. The publication of a notice (which includes advertising material) is specifically declared to be conduct that falls under the prohibition to engage in conduct that is misleading or deceptive in relation to a MIS (s1041H CA; s12DA ASIC Act). ASIC can

take a number of actions to enforce compliance.

Investment policy and risks

The regulatory framework does not stipulate any particular investment or trading policy or contain any restrictions on asset allocation. The investment powers of the RE must be specified in the constitution of the registered MIS (s601GA(1)(b) CA).

Information about the investment policy of a Standard MIS is also necessary in order to satisfy the RE's specific obligations to include information about the significant characteristics or features of the product in the PDS (s1013D(1)(f) CA). This information is also central to the description of the significant risks and benefits that are attached to the product. In addition, as the investment policy would be information that would have a material influence on the investor's decision to invest, it must be included in the PDS (s1013D(1)(f) CA). For a Simple MIS, information about the investment policy is required to be provided in the Shorter PDS (Sch 10E Item 7(7) CR). Information on the investment policy would also be included in the application for registration lodged with ASIC and in annual reports. In practice the PDS is the most important document for investors to understand the investment policy of a Retail MIS.

Powers of ASIC

A PDS for a Retail MIS that is traded or will be traded on a financial market must be lodged with ASIC for a seven day exposure period, i.e., the same rule applies as for prospectuses. A PDS in-use notice must be lodged with ASIC for PDS for all other Retail MIS. In practice ASIC does not review all the PDS for Retail MIS submitted to it during this exposure period (ASIC estimates that during the financial year 2010-2011 870 Retail MIS PDS were lodged with ASIC). However, ASIC reviews substantially all PDS for registered MIS that are to be traded on a financial market. In some cases where it considers the risk to be low, the review may not be comprehensive. In the case of non-quoted registered MIS, ASIC reviews only some of the PDS.

The criteria used to decide which PDS are reviewed are based on the identification of the compliance risks involved and the potential likelihood and consequences of the risks. For example, the PDS for several Retail CIS within an industry sector would be reviewed as part of a surveillance project considering the systemic risks that may exist within that sector, whereas a surveillance of the risk management or compliance processes of a specific RE would involve a review of the PDS issued by it. A PDS for the substantive restructuring of a Retail MIS would be reviewed to ensure that adequate disclosure about the restructuring is provided to members.

A PDS review may also be carried out as a result of reactive surveillance, where ASIC has reason to believe that there may be misconduct by a regulated person in respect of a financial product.

While most times corrective disclosure or withdrawal is agreed upon voluntarily, ASIC may issue a stop order if a disclosure document, statement or advertisement that relates to financial products is defective (s1020E CA). Under a stop order, ASIC can order that a conduct (such as the offer of further interests in the MIS using the defective PDS) must not be engaged in. ASIC also has a variety of powers to take criminal or civil action in relation to false, misleading or deceptive conduct engaged in by the RE in respect to the offer of interests in a MIS, or illegal offers which do not satisfy the lodgement requirements (see Principle 12 for further details).

ASIC has the power to ensure that any investment policy and trading strategy for a registered MIS is complied with. If a RE is not following its stated investment policy or trading strategy, the statements made would be misleading. It is a contravention to

	make misleading statements concerning the operation of a MIS (s1041H CA).
Assessment	Broadly Implemented
Comments	<p>The disclosure requirements for MIS are mostly based on the broad principle to disclose information on the significant characteristics, features, risks and benefits of a MIS rather than detailed requirements. These high-level principles appear to generally reach the desired outcomes for, among others, information on valuation and investment policy and risks. However, the lack of standard formats for Standard PDS and all non PDS disclosures, as required by Key Question 3 of the Methodology, is a deficiency that has a potential to impact on the investors' ability to effectively compare different MIS.</p> <p>As referred to under Principle 24, there is only limited data available on the assets under management by Wholesale MIS. There is no information on the nature of these Wholesale Funds. It is therefore difficult to draw any firm conclusions about the potential need to improve disclosures of Wholesale Funds, and the authorities are encouraged to engage in a more systematic analysis of the Wholesale Fund sector. Drawing the parallel to Principle 28 for hedge funds where disclosure to investors is required, it seems appropriate to consider some minimum disclosure requirements or guidance also for Wholesale Funds.</p>
Principle 27.	Regulation should ensure that there is a proper and disclosed basis for asset valuation and the pricing and the redemption of units in a collective investment scheme.
Description	<p>There are no requirements for the valuation of the assets of Wholesale MIS and the pricing and redemption of their units. The following therefore applies only to registered Retail MIS.</p> <p>Asset valuation</p> <p>The CA requires the RE to value the scheme property at regular intervals appropriate to the nature of the property (s601FC(1)(j) CA), and the compliance plan of a MIS must set out the arrangements to ensure compliance with this requirement (s601HA(1)(c) CA). It does not prescribe a time period for valuations to take place, nor the valuation method. This approach has been adopted as the CA recognises that what is appropriate timing for valuation of scheme property varies depending on the type of property.</p> <p>The constitution of a MIS must describe how the scheme property will be valued, if the consideration for the acquisition of interests in a MIS is based on the value of the property (RG 134.29), which is normally the case (the exceptions relate to the very broad scope of MIS in Australia). If discretionary pricing is used, the pricing policy may be contained in a document other than the constitution (s601GAB and 601GAC CA).</p> <p>In addition, the RE must lodge financial statements for each registered MIS at least annually (s319 CA). The balance sheet that shows the NAV is required to be prepared in accordance with Australian Accounting Standards. In relation to the fair value measurement of financial assets, REs must comply with specific regulatory requirements in Australian Accounting Standards if market prices are not available (s296 and 304 CA). In this situation, REs are required to have regard to valuation techniques based on market observable inputs, or in the absence of such inputs, non-observable inputs (AASB 139 Financial Instruments: Recognition and Measurement).</p> <p>ASIC and APRA have jointly published RG 94: Unit pricing - guide to good practice, which requires the development of sound and justifiable policies for asset valuation for unit pricing. These policies must be documented, explaining the methodologies, the assumptions, and why they are reasonable and appropriate for the assets.</p>

Independent auditors are required to assess whether the measurements and disclosures in relation to the assets of a MIS are in accordance with the accounting standards and to provide an audit opinion for the year-end financial statements (s301-302 CA). The compliance plan auditor must examine the adequacy of the RE's compliance plan that sets out the arrangements on how the scheme assets are valued, and whether the valuation processes have been complied with, and lodge with ASIC an annual audit report (s601HG CA).

Calculation and publication of subscription and redemption prices

The CA requires the constitution of a registered MIS to make adequate provision for the consideration (application price) that is to be paid to acquire an interest in the MIS (s601GA(1) CA). In order to meet this requirement, the consideration for acquiring an interest must be set out in the constitution so that it is independently verifiable. In practice, this means that an auditor must be able to verify the amount of consideration by referring to the constitution without requiring any information from the RE about how the RE exercises discretions (RG 134.25).

With regards to withdrawal rights, the regulatory regime draws a distinction between 'liquid schemes' and schemes that are not liquid. In any case, if members have a right to withdraw from a registered MIS, the scheme's constitution must specify the right and set out adequate procedures for making and dealing with withdrawal requests (s601GA(4) CA).

There are no legal or regulatory restrictions on the investors' right to withdraw from a 'liquid scheme' other than that the withdrawal must happen in accordance with the scheme's constitution. A 'liquid scheme' is a MIS where 'liquid assets' account for at least 80 percent of the value of scheme property (s601KA(4) CA). Assets that are generally considered liquid include money in an account or on deposit in a bank, bank bills and marketable securities. Any other property is a 'liquid asset' if the RE reasonably expects that it can be realized within the withdrawal period specified in the constitution (s601KA(6) CA).

If a MIS is not liquid, the RE must not allow a member to withdraw unless the requirements of s601KB–601KE CA are met (s601KA(3)(b)). It may offer members an opportunity to withdraw to the extent that it considers assets are available and able to be converted to money in time to satisfy members' withdrawal requests (s601KB CA). The RE is required to ensure that the requests for withdrawal are satisfied within 21 days of the close of the withdrawal offer (s601KD CA). If there is insufficient money to satisfy all the withdrawal requests, each member seeking to withdraw should be allocated an amount proportionate to its own withdrawal request compared to the total amount of withdrawal requests.

The PDS is required to disclose the redemption rights of MIS investors as part of disclosure of the significant features of the MIS. The withdrawal procedures must be fair to all members. Fairness will normally require that the withdrawal price depends on appropriate and reasonably current valuations of scheme property (RG 134.25). The 'independent verification' requirement for the application and withdrawal prices does not apply where formula based pricing occurs in accordance with CO 05/26 (see Principle 26).

A RE is to provide periodic statements at least once a year to existing investors (s1017D CA). The statement must contain, inter alia, the termination value of the investment at the end of the period, the return on investment over the period, and details of any change in circumstances affecting the investment that has not been previously notified. This ensures that investors receive information on the current value of their investment and therefore the price of interests in the MIS at least once a year. In

practice most REs disclose unit prices daily on their websites.

Pricing errors

A RE has a duty to report breaches of the CA to ASIC including any failure to price the units in accordance with the MIS constitution, valuation standards or requirements relating to exercise of discretion, that have a materially adverse effect on the interests of members (s601FC(1) CA). A RE also has a further obligation to report significant breaches or likely breaches of the RE's obligations as an AFSL holder to ASIC (s912D CA).

RG 94 recommends that if a material error is identified, all affected unit holders should be compensated in a manner that is fair to all unit holders, whether affected or not. The threshold test for compensation needs to be applied consistently in each instance and in good faith. ASIC has indicated that in some circumstances very small amounts (under A\$20) need not be compensated.

A member who suffers loss or damage as a result of a contravention by the RE is entitled to compensation (s601MA CA). ASIC has the ability to take action against a RE if a pricing error results in a material loss to member(s) and the RE does not provide compensation. In practice, REs have voluntarily met their compensation obligations under ASIC oversight.

ASIC can take action against the RE if it is of the view, for example, that the pricing error is indicative of a systemic problem relating to compliance with the constitution, the RE's duties or the RE's obligations as an AFSL holder. Mispricing constitutes a contravention of the constitution of the registered MIS and the CA, because the CA requires the constitution to address pricing and the RE to comply with the constitution. ASIC can enforce compliance through civil penalty orders and claims for contravention on behalf of the scheme for any loss (s601FC(1)(m), 601GA(1)(a), 601GA(4) and Part 9.4B CA).

In relation to unit pricing errors, ASIC has also accepted enforceable undertakings from REs requiring compensation of members; appointment of an external consultant to conduct a review of its unit pricing to ensure all pricing errors have been appropriately identified and reported to the board; and engagement of an external, independent, professional compliance consultant to review, assess and make recommendations to the RE on its current compliance arrangements. In light of voluntary compliance, this is a tool that has not been used in recent years.

Suspension of redemptions

If a registered MIS ceases to be a liquid scheme, routine redemptions must be suspended. This would arise, for example, if there was a market disruption that meant market value for the scheme property could not be ascertained. There is no specific obligation to notify ASIC if the assets of a registered MIS cease to be liquid, which would result in the withdrawal rights for liquid schemes being suspended. However, this would require the PDS to be updated and, if a supplementary PDS was issued, ASIC would be informed of the change by the submission of an in-use notice for the supplementary PDS (s1015D CA). However, this change would not be identified as specifically relating to the suspension of redemptions.

If a registered MIS is not a liquid scheme, redemptions that may be offered under a withdrawal offer are also subject to a requirement that the RE must cancel the offer before it closes if it is in the best interest of members to do so. This would arise, for example, if it appeared that proceeding with the offer would adversely affect the MIS's liquidity management or that it would not be possible to realize assets to provide funding for the withdrawal offer as had been intended. Where the cancellation of a

	<p>withdrawal offer for a non-liquid scheme occurs, the RE is required to lodge a notice with ASIC of the cancellation (s601KE(3) CA).</p> <p>A registered MIS which is also a disclosing entity must lodge with ASIC notice of any new information, such as a suspension of redemptions, which would commonly influence investors in deciding whether to acquire the product, unless it is already generally known (Ch 6 CA). Similar disclosure would be required when any significant suspension or deferral was ended.</p> <p>The CA does not expressly provide a mechanism by which valuations of MIS interests may be suspended. However, the RE's discretion under s601FC(1)(j) CA would allow for the suspension or deferral of a routine valuation of assets. This would carry over to the pricing of an interest in a registered MIS.</p> <p>ASIC is able to take enforcement action, if the provisions of the MIS constitution in relation to redemption rights are breached.</p>
Assessment	Fully Implemented
Comments	
Principle 28.	Regulation should ensure that hedge funds and/or hedge funds managers/advisers are subject to appropriate oversight.
Description	<p>Registration/authorization and regulatory requirements</p> <p>The overwhelming majority of hedge funds in Australia are structured as MIS.⁹ Therefore the requirements for the registration of a scheme sold to retail investors and for the authorization of the scheme operator are the same as for other MIS. Similarly, the prudential, organizational, conflict of interest and conduct of business requirements of the hedge fund operators are the same as those of other REs and AFSL holders (see Principle 24). Like in the case of other MIS, there are no regulatory requirements applicable to wholesale hedge funds, whereas their operators are generally subject to the requirement to hold an AFSL.</p> <p>The proportion of wholesale funds is higher in the hedge fund category than in the case of other MIS. According to an Austrade survey on Australian hedge funds (August 2011), the Australian and foreign institutional investors constituted 36 percent of the investor base in Australian hedge funds. The sector however remains small, with less than A\$ 50 billion of assets under management according to some estimates.</p> <p>Disclosure to investors</p> <p>The disclosure requirements for hedge funds are the same as for other MIS, i.e., they apply to retail hedge funds but not to wholesale hedge funds. The Australian Government announced on 22 December 2011 that all retail hedge funds (independent of whether they would qualify as Simple MIS on the basis of the liquidity of their assets) would be excluded from the Shorter PDS regime applicable to Simple MIS until their treatment can be fully considered in respect of the policy intent of that regime. ASIC is currently consulting on proposals to improve disclosure for retail investors in hedge funds (see CP 174 that follows an earlier CP 147), where it notes that it expects all retail hedge funds (as defined in the draft RG) to apply the disclosure principles proposed in the CP, regardless of whether the fund would meet the definition of a Simple MIS or not.</p> <p>Hedge fund PDS have been subject to increased scrutiny by ASIC. Since 2009, it has completed 21 reviews that have lead to one stop order, one voluntary withdrawal, and</p>

⁹20 hedge funds are currently structured as listed investment companies and are therefore subject to the CA provisions applicable to companies and ASX Listing Rules rather than the CA provisions applicable to MIS.

	<p>ten revisions to take into account ASIC comments. Seven cases did not require any further action and two schemes were wound up.</p> <p>Side letters are not permitted for retail MIS. This is because side letters can grant preferential rights, which conflicts with the RE's duty to treat members holding interests of the same class equally and members holding interests of different classes fairly.</p> <p>Disclosure to the regulator</p> <p>ASIC has the power to require production of information from the operators of both retail and wholesale hedge funds, if the information is in the possession or control of a party in Australia. Otherwise, ASIC would need to rely on the regulator in the relevant jurisdiction to gather this information under bilateral supervisory cooperation agreements. ASIC exercised its information gathering powers in late 2010 to require nine large hedge fund managers in Australia (controlling approximately half of the total known assets under management in single strategy funds in Australia) to disclose information about their operations and the funds managed by them. The purpose of the request was to help determine the level of systemic risk posed by the hedge fund sector to the broader financial market in Australia and globally.</p> <p>Hedge fund operators are not subject to any ongoing reporting requirements to ASIC of the funds in their portfolio or of the elements described in the explanatory notes to Key Question 5 of the IOSCO Methodology.</p> <p>Supervision and enforcement</p> <p>ASIC can apply its inspection, investigation, surveillance and enforcement powers to hedge fund operators in the same manner as to other regulated entities. ASIC has used these powers, e.g., by conducting in 2009 a thematic surveillance of a sample of hedge funds offered to investors in Australia to verify the existence of fund assets from third party service providers. Two other relatively extensive risk-based surveillance projects are currently ongoing. ASIC uses a risk-based methodology to prioritize its hedge fund surveillance activities.</p> <p>Section 127(4)(c) ASIC Act authorizes ASIC to release confidential information in its possession to a government or an agency of a foreign country if it is satisfied that the particular information will enable or assist that government or agency to perform a function or exercise a power, conferred by a law in force in that foreign country. Subject to the limitations described in Principle 15, ASIC is empowered to collect information on behalf of a foreign regulator under MABRA. In relation to criminal matters, the foreign regulator may seek assistance from the Attorney-General under MACMA.</p>
Assessment	Broadly Implemented
Comments	<p>Key Question 6 of the IOSCO Methodology requires the regulatory system, in view of the risk posed, to set standards for the proper disclosure by hedge fund managers/advisers or the fund to investors, without distinguishing between the requirements for retail and wholesale investors. As for other Wholesale MIS (see Principle 26), such standards do not exist for wholesale hedge funds in Australia. They do however exist for retail hedge funds, which according to Austrade's¹⁰ statistics currently constitute the majority of funds under management in Australian hedge funds, and ASIC has recently focused on improving the disclosure requirements of retail hedge funds.</p> <p>Key Question 8.(a) requires the regulatory system to provide for ongoing supervision of hedge fund managers/advisers. The Explanatory Notes further expand on this requirement by referring to the existence of comprehensive powers, the effective and</p>

¹⁰The Australian Trade Commission (Austrade) is the Australian Government's trade and investment development agency.

	<p>credible use of these powers and the implementation of an effective compliance program. ASIC has recently increased its efforts to complement its reactive surveillance approach through a relatively extensive risk-based surveillance program that includes desk-based and on-site surveillance targeting the main risks identified.</p> <p>ASIC has certain restrictions in its ability to collect information from Australian hedge fund managers/advisers on behalf of a foreign regulator (see Principle 15 for further details), as required by Key Question 9. This deficiency has been addressed in more detail under Principles 13 and 15.</p> <p>ASIC is able to obtain information from the operators of hedge funds about the funds they manage on an ad hoc basis, which complies with the minimum requirement of Key Question 5. Through the CA requirement for lodging the PDS of retail hedge funds with ASIC, it becomes informed of the developments in the retail hedge fund sector on an ongoing basis. Even if the Australian hedge fund sector still remains small by international standards, assessing the potential systemic risks arising from the sector is one of the key objectives of Principle 28. It would therefore be important for the authorities to assess how, going forward, they can best ensure sufficient information on the overall developments in the sector (see also comments on Principle 24).</p> <p>ASIC has recently taken significant steps in strengthening its hedge fund supervision, and it is encouraged to continue the current efforts to better understand the risks arising from this sector, in particular the systemic risks that it may pose to the wider financial system.</p>
Principles for Market Intermediaries	
Principle 29.	Regulation should provide for minimum entry standards for market intermediaries.
Description	<p>Firms requiring authorization</p> <p>In Australia, market intermediaries are regulated as AFSL holders. The financial services for which authorization is needed are: providing financial product advice, dealing in a financial product, making a market for a financial product, operating a registered MIS, and providing custodial or depository services. A firm executing client orders needs to be licensed for dealing. Provision of discretionary portfolio management services requires a license for dealing, providing advice, and providing custodial services (RG 179.31); the license also needs to entitle the firm to provide services in managed discretionary accounts which are considered to be financial products. In addition to the authorized financial services, all licenses identify the financial products authorized and whether the services can be provided to retail or wholesale clients or both.</p> <p>Market intermediaries that seek to become members of licensed market are subject to additional regulatory requirements under the MIRs and the operating rules of the relevant markets. Non-Market Participant market intermediaries access the market (for the purposes of fulfilling client orders) through a Market Participant. These intermediaries are subject to regulation as an AFSL holder, but are not subject to MIRs or the operating rules of any markets.</p> <p>Persons authorized in accordance with s916A or s916B CA to provide financial services on behalf of an AFSL holder may act as market intermediaries without holding an AFSL (so called authorized representatives). ASIC must be notified within 15 business days if an AFSL holder authorizes a representative to provide a financial service. The AFSL holders are accountable for the actions of their authorized representatives. An authorized representative is not generally permitted to sub-authorize further representatives.</p> <p>Requirements for authorization</p> <p>The minimum standards that apply to applicants for an AFSL are stipulated in the CA.</p>

ASIC must grant an AFSL if (and must not grant it unless):

- The application contains all necessary information and is accompanied by all the documents specified in the regulations (s913A CA);
- ASIC has no reason to believe that the applicant would not comply with the ongoing obligations of AFSL holders under s912A CA that include the following:
 - Do all things necessary to ensure that financial services are provided efficiently, honestly and fairly;
 - Have in place adequate arrangements for the management of conflicts of interest;
 - Have available adequate resources (including financial, human and technological) to provide the financial services covered by the licence and to carry out the supervisory arrangements; and
 - Have adequate risk management systems.
- ASIC has no reason to believe that the applicant (or its responsible officers if the applicant is a body corporate) is not of good fame or character;
- The applicant has provided ASIC with any additional information that ASIC has requested; and
- The applicant has met any other requirement imposed by regulation.

Licensing process

The licensing process starts with an online application that includes three parts: types of authorizations requested and information about business; competencies of named “responsible officers”; and questions about more complex products/services (e.g., derivatives, FX, operating a MIS, making a market) for which authorization is sought. The applicant also needs to submit supporting documents on paper (business description, people proofs, and financials). ASIC has a dedicated team of analysts whose primary role is to assess applications for AFSLs and applications to vary licences on a risk assessment basis. It risk rates the applications taking into account intelligence it has, size/nature of the business, financial products offered, and the type of clients (wholesale/retail). This process is partially automated. If an applicant receives a higher risk rating, ASIC may request additional proofs on compliance, risk management, and management of conflicts of interest. Specific proofs are required for certain products and services. This process is transparently set out in ASIC’s Licensing Kit (RGs 1, 2 and 3).

The licensing requirements include initial capital requirements that are described under Principle 30. The licensing process also includes an assessment of the sufficiency of the internal organization and risk management systems of the applicant, with applicants for ASX and Chi-X Market Participant status having to supply certain additional information. ASIC’s assessment of internal organization and risk management is based on a series of relatively detailed questions on the compliance arrangements, supervision and monitoring of representatives, dispute resolution systems and risk management of the applicant. Additional supporting documents are also required in certain cases.

ASIC can refuse an AFSL if the applicant does not meet the requirements of the CA. It can also impose or vary the conditions on an AFSL as a means of ensuring an AFSL holder complies with its obligations. This can happen only after the applicant has been provided with an opportunity to appear and be represented at a private hearing before ASIC where it is entitled to put submissions to ASIC about the matter.

Where the holder of an AFSL (other than an ADI) is subject to prudential regulation, ASIC must consult with APRA prior to imposing, revoking or varying any AFSL

conditions or suspending or cancelling an AFSL, if the changes in ASIC's opinion could prevent the AFSL holder from carrying out its usual activities that are regulated by APRA. In other cases ASIC is required to inform APRA within a week of its action. Where the AFSL holder is an ADI, the powers conferred on APRA are exercised by the Minister. ASIC, however, would still be responsible for conducting any hearings and considering any submissions from the AFSL holder on behalf of the Minister. Where the Minister was not required to be involved, ASIC needs to inform APRA of its decision.

As part of the process, ASIC assesses the responsible officers of the applicant through its good fame and character test (s913B CA). Section 9 of the CA defines responsible officers as being "an officer of the body who would perform duties in connection with the holding of the license". ASIC has interpreted this to mean each responsible manager who is put forward as providing financial services and each director of the company on the basis that each director has responsibility for the operation of the company. If ASIC is aware that another officer, who has not been put forward as a responsible manager has, in ASIC's view, influence in the provision of financial services, that officer will also be subjected to the good fame and character test.

ASIC's assessment does not extend to any direct shareholders or other persons that are in a position to exercise control or materially influence the applicant through a predetermined amount of ownership or voting power in the applicant. There are further requirements for admission as a Market Participant in the relevant markets that are publicly available on the ASX Group and Chi-X Australia websites. According to Section 1 of their Operating Rules, they retain full discretion to approve or refuse an application for a participant status or to impose any conditions on the admission. However, the general requirement of the market operators to ensure that their licensed markets are fair, orderly and transparent, would according to the market operators require them to treat the applicants for participation fairly and equitably.

Suspension or cancellation of an AFSL

Under s915B CA, ASIC may suspend or cancel a person's AFSL without holding a hearing in certain situations, for example where the AFSL holder ceases to carry on a financial services business, becomes an insolvent under administration or is convicted of a serious fraud, or the application for the licence was materially false or misleading, or if there was an omission of a material matter from the application.

ASIC may, after a hearing, suspend or cancel an AFSL if it has reason to believe the AFSL holder has not complied or will not comply with its obligations under s912A CA; ASIC is no longer satisfied that the AFSL holder (or one of its responsible officers, partners, or trustees) is of good fame and character; or a banning order has been made against the AFSL holder or one of the AFSL holders' representatives and ASIC considers this will impair the ability of the AFSL holder to meet its licence obligations. ASIC has the power to ban a person either permanently or for a specified period under s920A and 920B CA, among other things, where the person is convicted of fraud or has not complied with a financial services law. Additional requirements apply to the employment by Market Participants of certain persons who have committed securities law violations or who may otherwise be unsuitable.

Ongoing requirements

Regulation 7.6.04 CR contains certain ongoing notification requirements imposed on AFSL holders (s914A(8) CA). These include requirements to notify ASIC within at least three business days if an event occurs that may make a material adverse change to the financial position of the AFSL holder and a requirement to notify ASIC within 10 days if there is a change in the control of the AFSL holder. Under the relevant market's operating rules, Market Participants are also under an obligation to self-report certain matters.

	<p>Publicly available information</p> <p>Key information about AFSL holders, including the financial services they are authorized to provide, is publicly available on ASIC's website. It is also possible to search online and obtain the information about authorized representatives, including a list of all AFSL holders that have authorized a particular representative. An AFSL holder has to keep available for inspection a copy of its AFSL and provide free of charge a copy of the authorization of its authorized representatives.</p> <p>If the AFSL holder is a body corporate, details of officeholders (directors, secretary) are available to the public via ASIC's database. Details of all responsible officers nominated on an AFSL are publicly available through an extract that can be obtained from ASIC. In the event that ASIC considers that the AFSL holder is heavily dependent on the expertise of one or two responsible officers who are directly responsible for day-to-day provision of financial services, it will designate these persons to be 'key persons' and name them on the AFSL.</p> <p>A list of Market Participants is publicly available on the ASX Group and Chi-X Australia websites.</p> <p>Investment advisers</p> <p>All investment advisers, independent of whether they deal on behalf of clients, hold client assets or manage client portfolios, are subject to the same requirements as other AFSL holders. This includes licensing, capital and organizational requirements as well as requirements on record keeping, disclosure and conflicts of interest (see also Principle 31).</p> <p>AFSL holders that hold client money are subject to the CA requirements on client money protection (Division 2 Part 7.8 CA). This is covered in more detail under Principle 31.</p>
Assessment	Broadly Implemented
Comments	<p>ASIC's licensing process appears thorough, even though it does not include an on-site visit or inspection. Due to this, it is recommended that ASIC pays particular attention to the effectiveness of its ongoing surveillance program, which should extend within a reasonable period of time to the new licensees. Currently this is not the case, which has been taken into account in the assessment of Principle 31.</p> <p>ASIC's good fame and character test does not extend to significant shareholders, persons holding a significant amount of voting power in the applicant or persons that are otherwise in a position to control or materially influence the applicant (directly or indirectly) other than by being a responsible officer. This is contrary to the approach applied to market operators and operators of clearing and settlement facilities. To achieve full compliance with the Principle, it would be sufficient to subject only the controllers of the applicant to such an assessment (Key Question 2.(d)). However, it is recommended that the authorities go beyond this minimum requirement by applying a suitable percentage of ownership, voting power and other relevant criteria to address all situations of material influence beyond a preset threshold level. It is recommended that information on those persons would also be required to be enclosed to the license application.</p>
Principle 30.	There should be initial and ongoing capital and other prudential requirements for market intermediaries that reflect the risks that the intermediaries undertake.
Description	<p>Capital requirements</p> <p>ASIC's financial resources requirements are set out as conditions in AFSLs, which holders must comply with continuously (Pro Forma 209 and RG 166). According to RG 166, the underlying principle of the financial resources requirements set out by ASIC is</p>

<p>to help ensure that an AFSL holder has sufficient financial resources to conduct its financial services business in compliance with the CA; that there is a financial buffer that decreases the risk of disorderly or non-compliant wind-up if the business fails; and that there are incentives for the owners to comply through risk of financial loss. ASIC specifically notes that it is not a prudential regulator and the financial resources requirements are not intended to ensure that an AFSL holder meets its financial commitments.</p> <p>The financial resources requirements applicable to different types of AFSL holders have been summarized in RG 166 as follows:</p>			
<p>Section A: General policy on financial requirements</p>			
<p>All licensees not regulated by APRA</p>	<p>Risk management systems must address risk to financial resources.</p>	<p>Holding an AFS licence</p>	<p>All licensees except APRA-regulated bodies</p>
<p>Section B: Base level financial requirements</p>			
<p>All licensees except licensees regulated by APRA and market and clearing participants that Section D says need not comply</p>	<p>Positive net assets and solvency. Sufficient cash resources to cover next 12 months' liabilities (including expected liabilities) for responsible entities, or next 3 months' liabilities (including expected liabilities) for all other licensees, with adequate cover for contingencies. Audit compliance annually and when ASIC asks.</p>	<p>Holding an AFS licence</p>	<p>Providers of financial product advice (advisers). Dealers. Responsible entities and IDPS operators. Custodial or depository service providers. Market makers. Trustee companies providing traditional services.</p>
<p>Section C: Managed investments, custody services, margin lending facilities and trustee companies providing traditional services</p>			
<p>Responsible entities and IDPS operators Providers of custodial or depository services Issuers of margin lending facilities Trustee companies providing traditional</p>	<p>For responsible entities, a minimum net tangible assets (NTA) requirement of the greater of A\$150,000, 0.5 percent of the average value of scheme property of the registered scheme(s) and IDPS operated (up to A\$5 million) or 10 percent of the average responsible entity revenue (with no</p>	<p>Acting as a responsible entity, IDPS operator, a provider of a custodial or depository service, a trustee company providing traditional services, or holding secured property or receiving transferred securities under a margin lending facility.</p>	<p>Responsible entities and IDPS operators. Custodial or depository service providers. Issuers of margin lending facilities. Trustee companies</p>

	services	maximum). NTA requirement of up to A\$5 million for IDPS operators, custodial or depository service providers, issuers of margin lending facilities and trustee companies providing traditional services.	This requirement is in addition to the requirements in Section B and, if applicable, Sections E, F and G.	providing traditional services.
Section D: Market and clearing participants				
	Market and clearing participants	Meet the requirements in the ASIC market integrity rules for the ASX, ASX 24 or Chi-X markets, or the ASX Clear's operating rules, or, if ASIC agrees, the operating rules of a market. Have adequate risk management systems, including addressing financial resources.	Requirements in Sections B, C, E, F and G do not apply to financial services businesses connected with participation in the market.	ASX, ASX 24 and Chi-X participants based on current ASIC market integrity rules. Participants in other licensed markets or licensed CS facilities if ASIC agrees.
Section E: Licensees holding client money or property				
	Licensees holding client assets	Surplus liquid funds (SLF) of A\$50,000.	Holding client assets over A\$100,000, including money in a separate account, or money or assets on trust for clients in certain situations. This requirement is in addition to the requirements in Section B and, if applicable, Sections C, F and G.	Some dealers. Trustee companies providing traditional services.
Section F: Licensees with financial obligations from transacting with clients as principal				
	Licensees owing liabilities or contingent liabilities by entering into transactions with clients	Tiered adjusted surplus liquid funds (ASLF) requirement from A\$50,000 to A\$100 million. ASLF calculation contains adjustments for assets and contingent liabilities. Requirement for board consideration when trigger points are	Having such liabilities or contingent liabilities beyond A\$100,000. This requirement is in addition to the requirements in Section B and, if applicable, Sections C, E and G.	Market makers. Underwriters. Some dealers. Foreign exchange dealers (who elect to comply with Section F). Some issuers of non-

	<p>reached.</p> <p style="text-align: right;">standard margin lending facilities.</p> <p>Section G: Foreign exchange dealers</p> <table border="1" data-bbox="422 399 1482 966"> <tr> <td data-bbox="422 399 665 966">Licensed foreign exchange dealers</td> <td data-bbox="665 399 958 966">A\$10 million tier one capital.</td> <td data-bbox="958 399 1250 966"> Financial services business of foreign exchange contracts. If financial services business is only of entering into foreign exchange contracts, Section F does not apply unless licensee elects to comply with Section F not Section G. This requirement is in addition to the requirements in Section B and, if applicable, Sections C, E and F. </td> <td data-bbox="1250 399 1482 966">Foreign exchange dealers (who elect to comply with Section G).</td> </tr> </table> <p>Risk sensitivity of the financial resources requirements</p> <p><i>APRA regulated entities</i></p> <p>As indicated by the above table, ASIC does not impose any financial resources requirements where an entity is subject to APRA’s supervision (s912A(1)(d) CA). Instead, APRA applies the risk-based Basel II Standardized Approach to capital requirements of such entities and monitors compliance with them. APRA also has the power to adjust the capital requirement of an APRA-regulated entity to capture an identified risk not included in the standard methodologies.</p> <p><i>Clearing Participants</i></p> <p>The ASIC or APRA financial resources requirements do not apply to Clearing Participants. Instead, ASX Clear and ASX Clear (Futures) have primary responsibility as CSFL holders for setting their capital requirements, subject to ASIC’s approval, and monitoring Clearing Participants’ compliance with them. Since all Chi-X trades must be cleared through ASX Clear (see Principles 33-36), ASX Clear’s capital requirements apply also to Chi-X Clearing Participants.</p> <p>ASX Clear and ASX Clear (Futures) apply different capital requirements, due to historic reasons. ASX Clear imposes a minimum capital requirement of A\$20 million for General Clearing Participants and A\$5 million for Direct Clearing Participants. There are also additional capital requirements based on current risk exposures, including operational risk, counterparty/credit risk, position risk and market risk, as well as any unusual or extraordinary risks. The risk weight varies depending on the type of risk exposure, and can be up to 100 percent.</p> <p>ASX Clear (Futures) Clearing Participants have capital requirements that set a minimum level of net tangible assets (NTA) at A\$5 million. To avoid additional reporting requirements, a participant must maintain over 1.5 times the minimum capital requirement, which leads to a practical minimum capital requirement of A\$7.5 million.</p>	Licensed foreign exchange dealers	A\$10 million tier one capital.	Financial services business of foreign exchange contracts. If financial services business is only of entering into foreign exchange contracts, Section F does not apply unless licensee elects to comply with Section F not Section G. This requirement is in addition to the requirements in Section B and, if applicable, Sections C, E and F.	Foreign exchange dealers (who elect to comply with Section G).
Licensed foreign exchange dealers	A\$10 million tier one capital.	Financial services business of foreign exchange contracts. If financial services business is only of entering into foreign exchange contracts, Section F does not apply unless licensee elects to comply with Section F not Section G. This requirement is in addition to the requirements in Section B and, if applicable, Sections C, E and F.	Foreign exchange dealers (who elect to comply with Section G).		

Non-Clearing Market Participants

Non-Clearing Market Participants of ASX and Chi-X have similar risk-based capital requirements as ASX Clear Clearing Participants set out in the ASX and Chi-X MIRs. The minimum capital requirement is A\$100,000.

According to ASX 24 MIRs, its Non-Clearing Market Participants are subject to virtually the same NTA regime as ASX Clear (Futures) Clearing Participants except that the minimum NTA is A\$1 million (i.e., A\$1.5 million in practice). These requirements are over and above daily margin requirements covering potential daily mark-to-market losses.

ASIC is responsible for monitoring the compliance of Non-Clearing Market Participants with their capital requirements.

Other market intermediaries

As indicated by the above table, the licensees with financial obligations from transacting with clients as principal (Section F above) are subject to the requirement to hold Adjusted Surplus Liquid Funds (ASLF) on a tiered basis, whereas the licensees holding client money or property (Section E above) are subject to the Surplus Liquid Funds (SLF) requirement. In these two cases, the amount of capital the licensees need to hold increases as their liabilities increase. The riskiness of assets is addressed in the ASLF calculations in the form of a discount factor that is applied to certain assets to reflect uncertain recovery values. The ASLF and SLF regimes, however, are not risk-responsive in the same way as the requirements applicable to Clearing and Non-Clearing Market Participants and APRA regulated entities. Therefore no other market intermediaries than the entities falling in the latter three categories are subject to risk-based capital requirements as required by the Principle. These intermediaries can be engaged e.g., in dealing, market making or underwriting, i.e., activities that can expose them to counterparty and market risks.

ASIC is responsible for monitoring the compliance of all these other market intermediaries with their financial resources requirements.

Ongoing review of financial resources requirements

As part of its processes to review standards applicable to its regulated population, ASIC is currently undertaking a progressive review of the financial resources requirements (FRR) applying to all AFSL holders. The review has been finalized for responsible entities (the result of which is already reflected in the above table), and retail over-the-counter derivatives issuers. For the latter, the new requirements will replace their current ASLF obligations and require them to hold NTA equal to the greater of A\$1 million or 10 percent of average operating revenue. ASIC has also consulted on new requirements for IDPS operators and Electricity Derivative Issuers.

According to information provided by ASIC, it applies the following principles in the ongoing and future reviews of the existing levels of FRR:

- Skin in the game: Equity owners should have sufficient 'skin in the game' to ensure they are committed to the success of the business and compliance with the licensee's legal obligations.
- Unexpected losses and expenses: Licensees should hold appropriate financial resources against operational risks that can lead to unexpected losses. 'Appropriate financial resources' should be sized to match these risks.
- Buffer against disorderly winding-up: A minimum Net Tangible Assets (NTA) should provide an adequate floor to meet the administration costs of smaller licensees. As a licensee's business grows, the costs of winding up will likely increase.
- Basic organizational capacity: Increasing the minimum FRR will improve the licensee's basic systems and infrastructure.

	<ul style="list-style-type: none"> • Simplify requirements: By reducing complexity through replacing the current ASLF requirement with a NTA requirement, ASIC will be better able to verify compliance, compliance costs will fall for licensees and the requirements will be less subject to differing interpretations. • Alignment with comparable regimes: In some cases, the minimum FRR should be increased to align with comparable overseas regulatory regimes of ASIC's peers. <p>Reporting requirements</p> <p><i>Market Participants (Clearing and Non-Clearing)</i></p> <p>Market Participants need to prepare and submit the following reports (either to ASX Clear, ASX Clear (Futures) or ASIC), depending on whether they are Clearing Participants or not)¹¹:</p> <ul style="list-style-type: none"> • Monthly reports, generally within two/four weeks of the end of the month (depending on the type of participant); • An audited annual report, generally within three months after the end of the financial year; • More frequent reporting in the following cases: <ul style="list-style-type: none"> • Weekly (daily) reports where ASX/ASX Clear Participant's capital has dropped to less than 1.2 (1.1) times the minimum required level; • A report (potentially daily) where ASX 24/ASX Clear (Futures) Participant's capital has dropped below 1.5 times the minimum required level; • A report (potentially daily) where the ASX Clear (Futures) Participant's capital level falls by more than 20 percent since the previous report • An ad hoc report where ASX Clear, ASX Clear (Futures) or ASIC (as appropriate) so requests. <p>If the Market Participant fails to comply with any of its additional reporting requirements, ASIC, ASX Clear or ASX Clear (Futures) can impose penalties or, for more serious breaches, require the participant to cease activity.</p> <p><i>Other market intermediaries</i></p> <p>All AFSL holders must monitor their compliance with the financial resource conditions on their AFSL on an ongoing basis (ss912A(1)(b) and (d) CA). They must notify ASIC, where there is a material adverse change to their financial position, within three days of becoming aware of the event (reg 7.6.04(1) CR). They must also notify ASIC within ten business days of becoming aware of a breach of their licence conditions, which includes a breach of their financial resource requirements under RG 166 (s912A and s912D CA). AFSL holders must also lodge notices with ASIC when their financial resources fall to specified trigger points, for example, 1.2 times the minimum (RG 166.122-126.)</p> <p>AFSL holders must prepare and lodge a financial report annually, accompanied by an auditor's report, generally within three months after the end of the financial year (s989B and s989D CA).</p> <p>Audit and review of financial position</p>
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¹¹There are currently 34 Non-Clearing Equity Market Participants and eight Non-Clearing Futures Market Participants that report on a monthly basis to ASIC. The rest of the Market Participants report to ASX as Clearing Participants.

The annual reports of Market Participants and other AFSL holders must be audited by an independent auditor and accompanied by an audit report. In addition, the auditor is required to provide an opinion on a positive assurance basis that the AFSL holder complied with ASIC's financial requirements.

ASIC may review an AFSL holder's compliance with the financial requirements imposed by the law or in the conditions of a licence, particularly if it has specific intelligence that suggests a possible breach. ASIC has also reviewed qualified audit reports where the auditor has identified a failure to meet the AFSL holder's financial requirements.

ASIC can vary, revoke or impose additional conditions on the AFSL holder's license if it does not satisfy its financial requirements. ASIC can also consider suspension or cancellation of the AFSL, subject to the right of the AFSL holder to attend a hearing before ASIC and to lodge submissions on the matter. If the AFSL holder's financial position has deteriorated to the extent that it is insolvent or under administration, ASIC can immediately suspend or cancel the AFSL without being required to hold a hearing.

Further, the licence conditions have an embedded sanction on AFSL holders who must hold ASLF. Under that sanction, if the AFSL holder is required to have ASLF of more than A\$50,000 and its ASLF is below certain trigger points, it must not enter into any transactions with clients that could give rise to financial obligations, until its governing body has certified in writing that there is no reason to believe that it may fail to meet its licensee obligations.

For Non-Market Participants, ASIC has rarely used its licence variation power due to the firm being unable to satisfy its financial requirements. However, in 2011 ASIC sought and obtained licence condition variation orders for one intermediary in response to concerns about its financial position and compliance with the ASLF requirement. ASIC has also recently used the embedded sanction mechanism relating to the ASLF requirement in the case of another AFSL holder.

ASIC has reviewed each monthly report ASX, Chi-X and ASX 24 Non-Clearing Market Participants have submitted to it under the respective MIRs since it took over responsibility for these participants in August 2011. The review includes checking the reports for completeness, carrying out a review for any significant changes in balance sheet and profit and loss items from period to period and carrying out an analysis of the key capital ratios to ensure that Market Participants are in compliance with their minimum required capital ratios. If needed, ASIC sends written queries to Market Participants on the basis of the observations that it has made from the reports. ASIC has also completed one onsite review of a participant to check the data entered into its reports.

ASX Clear and ASX Clear (Futures) review the returns submitted by Clearing Participants under their Operating Rules. ASIC may review these returns if it has concerns about a participant or ASX Clear or ASX Clear (Futures) has alerted it to a problem.

Where a return indicates that a Non-Clearing Market Participant is not complying with the risk-based requirements in the ASX MIRs, ASX 24 MIRs or Chi-X MIRs, ASIC can penalize the participant up to A\$1 million, A\$100,000 or A\$20,000, depending on the rule being breached. ASIC may also give the participant a direction and, if the participant does not comply, seek a court order requiring compliance (s798J CA). Where a Clearing Participant is not complying with the ASX Clear or ASX Clear (Futures) Operating Rules, it can be penalized under the Operating Rules of the clearing facilities.

ASIC took over the supervision of the Non-Clearing Market Participant capital requirements in August 2011. So far it has not prosecuted a capital breach under the new ASX MIRs or ASX 24 MIRs. Between 2001 and February 2012, ASX Group issued 26 determinations against participants on capital requirements. This figure covers

	<p>measures taken both against Clearing and Non-Clearing Market Participants (the latter until August 2011).</p> <p>Unlicensed affiliates</p> <p>With the exception of APRA regulated entities, the capital adequacy requirements are imposed only at the level of the AFSL holder. They do not directly address risks from unlicensed affiliates and are not applied on a consolidated basis.</p>
Assessment	Partly Implemented
Comments	<p>With the exception of the capital requirements on APRA regulated entities and Market Participants (both Clearing and Non-Clearing Market Participants), the current requirements applied to other AFSL holders are not structured to result in capital addressed to cover all the risk types to which market intermediaries are subject, as required by Key Question 2 of the Methodology. For this reason, neither are they sensitive to the quantum of risks undertaken (Key Question 3). The assessment did not cover the principles that ASIC is currently applying in the revision of the financial resources requirements of all AFSL holders, because they were not available at the time of the assessment visit.</p> <p>For other than APRA regulated entities and Market Participants, there is currently no periodic reporting on the level of capital maintained by a market intermediary (Key Question 6). In these cases, ASIC relies on self-reporting by the intermediaries or reporting by their auditors to identify deterioration in capital levels or breaches of capital requirements. Finally, the Australian prudential framework does not directly address risks from unlicensed affiliates for other than APRA regulated market intermediaries (Key Question 10).</p> <p>It is recommended that the authorities introduce capital requirements directly related to the nature and amount of risks undertaken by all market intermediaries. This would also provide an opportunity to simplify and harmonize the current regime that is very complex and does not facilitate comparisons of the risk levels of various types of market intermediaries. The current arrangement where the responsibility for receiving and reviewing the capital adequacy reports rests on several bodies (ASIC, APRA, ASX Clear, and ASX Clear (Futures)) further complicates effective supervision of market intermediaries and forming and maintaining an overview of the risks arising from entities active in securities markets. The authorities should consider whether the current allocation of responsibilities for setting and monitoring the capital adequacy requirements among various public and private bodies is appropriate going forward, also in light of the requirements imposed by Principle 6 (see also Principle 31 for overall comments on the supervision of market intermediaries).</p>
Principle 31.	Market intermediaries should be required to establish an internal function that delivers compliance with standards for internal organization and operational conduct, with the aim of protecting the interests of clients and their assets and ensuring proper management of risk, through which management of the intermediary accepts primary responsibility for these matters.
Description	<p>Role of management</p> <p>The requirement for an AFSL holder to have in place appropriate management and organizational structures is not explicit in the regulatory obligations that apply to an AFSL holder. However, ASIC's position is that without appropriate management and organizational structures, the AFSL holder would not be able to meet its general obligations set out in RG 104. RG 104 also includes ASIC's guidance to AFSL holders that outsource their functions. Under ASX and Chi-X MIRs, a Market Participant is also required to have appropriate management structures in place.</p> <p>AFSL holders must establish and maintain compliance measures, processes and</p>

procedures to ensure that, as far as reasonably practicable, they comply with the financial services laws. Further, AFSL holders must have in place processes and procedures for monitoring these compliance measures and reporting and acting upon any compliance breaches. ASX and Chi-X Market Participants are required to have appropriate supervisory policies and procedures to ensure compliance with the MIRs, Operating Rules and the CA.

RG 104 requires an AFSL holder to ensure that its governing body has signed off on compliance measures and that a director or senior manager has been appointed to oversee those measures. The responsible executives of ASX and Chi-X Market Participants are accountable to the Market Participant for the effective design, implementation, functioning and review of the operations and processes that are needed to achieve compliance with the MIRs and the Operating Rules. The Market Participants must also ensure that each of their responsible executives performs an annual review of the supervision and control procedures and attests that the controls in place are, and continue to be, reasonably designed, implemented and functioning for the Market Participant to achieve compliance with the MIRs and Operating Rules.

Regular reporting to management on the business would usually be considered necessary in order for AFSL holders to meet their general obligations under s912A of the CA. ASIC expects a director or senior manager to be appointed with responsibility for reporting regularly to the governing body as part of the director's or senior manager's responsibility for compliance measures (RG 104). As part of the risk management systems of an AFSL holder, ASIC would expect it to have procedures intended to maintain the security, availability, reliability and integrity of information reported to management. Since APRA-regulated AFSL holders are waived from the CA requirements on risk management, they must comply with APRA's requirements in this area.

Internal control and risk management

There is no requirement for AFSL holders to be subject to an objective, periodic evaluation of their internal controls and risk management processes through e.g., an internal audit function.

With regards to compliance, ASIC notes in RG 104 that it may be sensible for AFSL holders to consider an external review of their compliance measures, processes and procedures to evaluate their appropriateness and effectiveness. Where compliance issues have arisen (such as major breaches or repeated compliance failures), ASIC considers an external compliance review to be particularly appropriate.

Section 912A(1)(a) CA requires an AFSL holder to do all things necessary to ensure that financial services are provided efficiently, honestly and fairly. The firm's processes and procedures, including its dealing practices, must support this obligation. There are no specific regulatory requirements for segregation of key duties and functions to prevent undetected errors or abuse when performed by the same individual. Instead, the regulatory framework relies on the compliance, risk management and conflict of interest requirements to reach the same outcome. ASIC is of the view that these requirements are in practice sufficient to address any issues relating to internal controls, and it regularly addresses internal control deficiencies in its surveillance activities.

Compliance function

ASIC conducts a detailed assessment of an intermediary's compliance function when an intermediary applies for an AFSL. This assessment takes into account the intermediary's size and business. If ASIC becomes aware of any deficiencies in the AFSL holder's compliance function, they are resolved in most cases by the participant rectifying the issue of concern and putting in place agreed remediation plans. These plans are received by ASIC and reviewed, with implementation confirmed by a third

party review or a further review visit by ASIC.

Conflicts of interest

AFSL holders have a specific obligation to have in place adequate arrangements for the management of conflicts of interest (s912A(1)(aa) CA). They are required to consider how their organizational structure, physical layout, and reporting processes affect their conflicts management (RG 181). This is not intended to prohibit all conflicts of interest or provide that an AFSL holder can never provide financial services if a conflict of interest exists. Rather, it requires that all conflicts of interest be managed adequately, including through disclosure. However, in circumstances where conflicts of interest cannot be managed, the AFSL holder must avoid the conflict or refrain from providing the affected financial service.

There is a statutory obligation on an AFSL holder to give priority to client orders. An AFSL holder is prohibited from entering into a transaction on its own or an associate's behalf (or instructing another person to act on its behalf) to purchase or sell financial products that can be traded on a licensed market, while a client's instructions to buy or sell that financial product have not been fulfilled (s991B CA). This prohibition does not apply where the client's instructions are conditional and the conditions have not been met. The MIRs include additional requirements applicable to Market Participants dealing in the markets on behalf of their clients and on own account.

Direct electronic access

Under Part 5.6. of the MIRs, a Market Participant that uses the trading system must use appropriate automated filters (see Principle 33). In addition, ASX Market Rules Guidance Note No. 22 requires ASX Trading Participants to adopt and enforce written procedures reasonably designed to prevent customers from entering into trades that create undue financial risks for the Clearing Participant. The procedures are required to address pre-execution and post-execution controls. ASIC is in the process of consulting on this subject before publishing ASIC guidance in an RG to replace ASX Market Rules Guidance Note No. 22.

Client assets

The CA contains a regime of client money protection which applies to AFSL holders that hold client money (Division 2 Part 7.8 CA). Where an AFSL holder receives client money, it is required to pay that money into an account with an ADI or an account approved in the CR. This money is to be paid into the account that day or the next business day at the latest. Client money must be kept in a separate account from the funds of an AFSL holder. There is no requirement to maintain separate accounts for each client. The client account has to be operated as a trust account and all moneys paid into the account are to be held on trust for the person entitled. Client money (or an authorized investment made with that money) cannot be taken in satisfaction of a court judgement or used to set off against other debts, unless so directed by the client. Similar provisions apply in relation to the holding of client assets (s984A CA). The measures in place are also aimed at facilitating the transfer of positions and assisting in the orderly winding up in the event of financial insolvency of the AFSL holder. However, views were expressed that the CA insolvency provisions for AFSL holders do not currently operate to provide enough certainty for administrators about how to deal with client money in winding up an AFSL holder.

Investor complaints

Where an AFSL holder is providing financial services to retail clients, it is required to have a dispute resolution system that consists of an internal dispute resolution scheme and membership of an external dispute resolution scheme (s912A(2)(b) CA). The internal dispute resolution scheme has to meet the standards set by ASIC, while the external dispute resolution scheme has to be one approved by ASIC. ASX, ASX 24 and

Chi-X Market Participants are subject to some additional obligations on how to deal with customer complaints.

Know your customer requirements

The requirements to identify the client and verify the client's identity are not set out in the CA. They are set out in the Anti-Money Laundering and Counter-Terrorism Financing Act 2006 (AML/CTF Act). The AML/CTF Act requires that a reporting entity must verify a customer's identity before providing a "designated service" to the customer. A reporting entity is a person that provides a designated service. ASIC has expressed a view that all AFSL holders (with the exception of financial advisors that only provide financial product advice and do not engage in dealing or arranging a dealing in securities or derivatives) are reporting entities that are required to have customer identification procedures under the AML/CTF legislation. However, AUSTRAC rather than ASIC is responsible for administering this legislation, and IOSCO Methodology does not extend to assessing the AML-CTF requirements in the jurisdiction.

ASX has published non-mandatory guidelines for information to be obtained when opening new client accounts. There is also a recommendation that Market Participants adopt policies and procedures relating to verification of client details, fraud control measures to prevent the opening of fictitious accounts, circumstances when additional client inquiries are necessary, and record retention. There are no equivalent requirements for Non-Market Participants.

Where an AFSL holder or its authorized representative is providing personal advice to a retail client, it must only provide that advice if it has made reasonable inquiries about the personal circumstances of the client (objectives, financial situation and needs) and the advice to be given is appropriate on the basis of its assessment of those circumstances (s945A(1) CA). There are no similar requirements when other financial services are provided.

Record-keeping requirements

Under s988A CA, AFSL holders are required to comply with record-keeping requirements that include the obligation to keep financial records that correctly record and explain the transactions and financial position of the financial services business carried on by the AFSL holder. The records must include the details of the client, the person who gave the instructions, the instructions themselves, and date and time details (7.8.19 CR). In relation to instructions to deal on licensed markets and foreign markets, an AFSL holder must keep records that disclose particulars of those instructions, and where received on behalf of a client, details of the client (s991D CA, 7.8.19 CR). These records are to be retained for a period of seven years after the transaction was completed in the case of financial records, and for five years for other records (s1101C CA). Further, it is a standard licence condition that Statements of Advice be kept for seven years (Pro Forma 206, licence condition, item 57). Specific requirements are imposed on Market Participants to maintain records in relation to dealings on behalf of clients.

Information to clients

To assist a retail client to decide whether to acquire a financial service such as personal advice from a market intermediary, there is an obligation to provide the client with a Financial Services Guide (s941A CA), which provides information about the AFSL holder and the financial services it provides. The information has to be such as a person would reasonably require for the purpose of making a decision whether to acquire financial services from the AFSL holder or authorized representative (s942B(3) and s942C(3) CA). The Financial Services Guide is required to include information about the remuneration (including commission) or other benefits the providing entity

and other relevant entities and persons are to receive in respect of, or that is attributable to, the provision of any of the authorized services.

A written Statement of Advice must also be provided if advice is given to retail clients, and that advice takes into account their personal circumstances (s946A CA). The legal requirements for Statements of Advice are designed to ensure that retail clients are given sufficient information to enable them to understand, and decide whether to rely on, personal advice provided to them. The Statements of Advice need to include information about various fees, charges, expenses, benefits and interests.

In addition, before a retail client acquires a particular financial product or security, it must be provided with a disclosure document. Depending on the nature of the product that document might be a PDS (Part 7.9 Division 2 CA) or a prospectus (Chapter 6D CA). The purpose of requiring the provision of these documents is to disclose information about the particular securities or financial products to enable the client to make an informed decision about whether to acquire them. Further, section 1016A CA requires certain sales or an issue of financial products to retail clients to be done by way of an 'eligible application'. An eligible application requires the application to be made via an application form to be accompanied by a PDS, prospectus or other disclosure document.

There is a specific requirement for the providers of managed discretionary account (MDA) services to retail clients to enter into an MDA contract before providing MDA services to a client. In addition, Market Participants are required under the MIRs to enter into client agreements in respect of certain predefined instruments. Otherwise there are no specific regulatory requirements to have a written contract with a client.

MDA clients need to be provided with quarterly reports on the transactions effected as part of the MDA service, the value of assets, and all revenues and expenses or, alternatively, electronic access to information on a substantially continuous basis. Otherwise there is no general requirement to provide a client with statements of account except in the case of financial products with an investment component (e.g., MIS) where clients have to receive a periodic statement at least annually.

There are also requirements for retail clients to be provided with a confirmation of transaction, where the client acquires a financial product, disposes of a financial product or is otherwise involved in a transaction while holding that financial product (s1017F CA).

Best interest of clients

There is no general requirement in the Australian regulatory framework requiring intermediaries to act in the best interest of their clients. However, section 912A CA imposes general obligations on AFSL holders that require them to do all things necessary to ensure that the financial services covered by the licence are provided efficiently, honestly and fairly, and to have in place adequate arrangements for the management of conflicts of interest. However, according to ASIC staff this requirement is not always sufficient to reach the same regulatory outcome as a best interest to client requirement.

There are some specific requirements on certain market intermediaries, such as Market Participants and providers of personal advice, that relate to a best interest type duty to clients. For example, ASX 24 Market Participants are subject to an obligation under the market integrity rules to not act in a manner that may have a detrimental effect on the client's best interest. Further, FOFA reforms have introduced a duty for financial advisers to act in the best interest of their clients, subject to a reasonable steps qualification, and place the best interest of their clients ahead of their own when providing personal advice to retail clients.

Supervisory program

The ASIC Market & Participant Supervision (MPS) stakeholder team is responsible for ASIC's policy making and supervisory activities in relation to Market Participants and Indirect Market Participants. As highlighted under Principle 3, it is responsible for the supervision of 137 Market Participants and approximately 700 Indirect Market Participants. In addition to organizing meetings primarily with Market Participants for the purpose of better understanding their business models, it conducts ASIC's proactive and reactive surveillance activities in its area of responsibility. Out of 54 MPS staff members, 19 are responsible for surveillance.

A key tool in the risk-based surveillance of Market Participants is ASIC's Risk Assessment Detection and Response (RADAR) system. MPS analysts update RADAR risk profiles on larger Market Participants regularly while a RADAR on smaller Market Participants may be conducted every three years. In 2010-11, 49 RADAR visits to Market Participants were conducted. The issues identified through RADAR assessments influence the thematic surveillance projects undertaken by MPS on compliance with specific MIRs and CA provisions (see below).

In addition, MPS has conducted work to identify the Indirect Market Participants by serving notices to the largest Market Participants requesting details on the AFSL holders that they provide services to. On the basis of this work, a list of 100 most important Indirect Market Participants was formed on the basis of the size of their business (> A\$50 million traded annually) and the number of clients (> 100 clients). ASIC is currently working through these firms with the intention of giving each a RADAR assessment; this is almost always accompanied with a visit to the supervised entity to gather more information. The aim is to subject these 100 Indirect Market Participants to ASIC surveillance every 4.5 years. In 2010-11, 21 RADAR visits were conducted on Indirect Market Participants. The remaining 600 of approximately 700 Indirect Market Participants account for limited trading activity and are only reviewed on a reactive basis when complaints or reports of misconduct are lodged with ASIC.

In the three years since April 2009, ASIC has assessed 55 Indirect Market Participants, using the full RADAR approach. Approximately 70 percent of these were taken from the list of 100 significant Indirect Market Participants. Approximately 30 percent were entities subjected to the full assessment for other reasons, such as a referral by MBR. Approximately 50 of the 55 received an on-site visit. The approach led to full remediation programs in six intermediaries (which has included assessments by independent consultants, changes to business processes and changes to AFSL conditions including removal of products). In ten further cases targeted improvement programs were developed with follow-up visits to validate and check process changes.

During the period from 1 August 2010 to 30 June 2011, MPS reviewed as part of its thematic reviews order records, trust accounts, compliance with margin requirements, adequacy of supervision of advisers at Market Participants, and adequacy of controls to prevent market manipulation by clients and prevent erroneous trades.

With regards to reactive surveillance, MPS may receive notices of suspected breaches by participants in several ways, e.g., through notification requirements, self-reported breaches, ASX referrals and complaints. Complaints may be referred to MPS by MBR for further processing (see Principle 12). During the period from 1 August 2010 to 30 June 2011, MPS reactive surveillance covered reviews of unauthorized trading; inappropriate advice to clients; misleading and deceptive claims in marketing and advertising material; churning of client portfolios; erroneous trades such as trades outside limits; and manipulative trading in specific securities and indexes by clients and the participants themselves.

	<p>Another important stakeholder team within ASIC with responsibility for the supervision of AFSL holders is Consumers, Advisers & Retail Investors (CARI) stakeholder team that is in charge of a regulated population amounting to 3,345 AFSL holders authorized to provide personal advice. In the past, it has done very little proactive surveillance work, but it recently launched a review of financial advice industry practice, which included in its phase 1 a review of the 20 largest AFSL holders that provide financial product advice to retail clients. This included a meeting with ASIC in case of most firms where ASIC provided interim feedback and further information.</p> <p>One of the reasons for ASIC conducting the review on financial advice was that it had little up-to-date information about AFSL holders providing financial advice and it also needed to understand better the adviser business models. As a result of the phase 1 review, ASIC published in September 2011 a report that highlighted the prevailing industry practices and included a series of recommendations on conflicts of interest, training, monitoring and supervision of advisers, product and strategic advice, complaints handling and compensation. Phase 2 that is currently underway will increase the population reviewed to a total of 50 firms.</p>
Assessment	Broadly Implemented
Comments	<p>In some areas, the principles based nature of the Australian regulatory regime for market intermediaries requires assessing whether the high level principles effectively lead to the same regulatory outcome as the detailed requirements set out in Principle 31. In most areas, this appears to be the case.</p> <p>An area where the principles based approach could be complemented with an additional explicit requirement relates to internal controls (Key Question 5). Even though compliance, risk management and conflicts of interest requirements partially aim at fulfilling similar regulatory objectives, a specific requirement for market intermediaries to maintain appropriate internal controls would provide enhanced legal backing for the supervisory activities that ASIC already conducts in this area. This could be combined with the introduction of an explicit requirement for periodic evaluation of the internal controls and risk management processes of AFSL holders as required by Key Question 3.</p> <p>As set out above, requirements to identify the client and verify the client's identity are not set out in the CA (Key Question 10). According to ASIC, appropriate requirements for market intermediaries exist in the AML/CTF legislation, which however falls outside the scope of the IOSCO assessment.</p> <p>There is uncertainty as to whether the portability provisions are fully effective (Key Question 8). This should be verified and, if needed, rectified as soon as possible.</p> <p>It is recommended that a general requirement to act in the best interest of the clients would be introduced, since such a requirement does not currently exist for all market intermediaries as required by Key Question 18.</p> <p>Key Question 19 requires the regulator to have in place a supervisory program. ASIC's RADAR system and related on-site visits ensure that all Market Participants are subject to ASIC's on-site surveillance at least every three years. The 100 most important Indirect Market Participants are expected to be subject to on-site surveillance every 4.5 years as a result of increased surveillance activities by ASIC during the past two years. The remaining 600 Indirect Market Participants remain subject only to reactive surveillance. Further, the AFSL holders providing investment advice have only recently become subject to ASIC's proactive surveillance activities.</p> <p>Despite the fact that a significant percentage of the regulated population may still remain uninspected for extended periods of time unless ASIC needs to take action on the basis of breach reports or complaints, ASIC has attempted to limit this population to those firms that are likely to pose the least amount of risks. It has also clearly expanded</p>

	its supervisory activities during the past few years. While the direction is correct, it is recommended that ASIC prepares a plan on how to further expand the scope of market intermediaries that are subject to its proactive supervision. This plan should be prioritized at ASIC level rather than for individual sectors of the regulated population using as convergent risk-assessment criteria as possible.
Principle 32.	There should be a procedure for dealing with the failure of a market intermediary in order to minimize damage and loss to investors and to contain systemic risk.
Description	<p>Early warning systems</p> <p>The following are the most relevant mechanisms that can give ASIC notice of a potential default of a market intermediary:</p> <ul style="list-style-type: none"> • ASIC’s RADAR system that subjects entities whose default would have a greater impact on the market to greater scrutiny (see Principle 31); • The automatic sanction element of the ASLF requirement that would alert ASIC of AFSL holders that might be at risk of breaching their financial resources requirements (see Principle 30); and • Monthly capital returns of Market Participants and more frequent reporting in case the capital falls below certain levels (see Principle 30). <p>In addition, ASIC considers that it can gather relevant intelligence and surveillance information through various other activities.</p> <p>Plans</p> <p>ASIC has joint plans with other authorities for dealing with the eventuality of a firm’s failure in the case of financial institutions that have systemic impacts. It participates in a cross-agency regulatory initiative known as the Financial Institution Response Plan (FIRP), which is designed to assist the regulators to respond effectively to an incident relating to a financial institution which would have the potential of affecting the stability of the Australian financial system. Such an institution would more likely be a financial institution regulated by APRA, but could also be a large non-APRA regulated broker, investment bank or fund manager. If the default of a financial institution would have systemic implications, FIRP would be implemented. ASIC’s own FIRP details the specific actions that ASIC may need to take and the support ASIC may need to provide to CFR if it makes a decision that the distress of a prudentially regulated body may have systemic implications. In a crisis situation, the CFR MoU would also guide the action to be taken.</p> <p>If there were no systemic implications for the Australian financial system, but the event would be significant for the financial markets, ASIC might decide to activate its internal Significant Market Event Response Plan (SMERP). This plan includes possible action to be taken e.g., in case of a broker default.</p> <p>ASIC’s plans in this area cover appropriate dissemination of information to the market that is the responsibility of the Corporate Affairs department.</p> <p>Powers</p> <p>ASIC has a range of powers that it could use in case of a failure of a market intermediary.</p> <p><i>Licensing decisions</i></p> <p>ASIC would be able to limit or prevent actions by an intermediary that is in financial difficulties by using its ability to impose or vary conditions on an AFSL (s914A(1)(a) CA). Before taking any measures, ASIC would have to provide the AFSL holder with an</p>

opportunity to appear and make submissions in a hearing (see Principles 4 and 29).

The fact that a market intermediary has become insolvent or has ceased to carry on its financial services business gives ASIC grounds to suspend or cancel the intermediary's AFSL (s915B CA) without having to hold a hearing or consider submissions from the AFSL holder. As soon as practicable, ASIC would publish a notice of the action in the Gazette and, if the AFSL holder was a participant in a licensed AML or CSFL, give written notice of the suspension or cancellation to the operator of the market or facility (s915F(2) CA). ASIC used this power in the case of Kinetic Securities Pty Ltd on August 15, 2011 due to Kinetic entering into voluntary liquidation.

Freezing of accounts

If an AFSL was suspended or cancelled, ASIC could apply to the court for an order to freeze or restrict the dealings of a person (that is, not just the AFSL holder) with accounts with a financial institution (s983A(3) CA), independent of whether the account is in Australia or not.

Where an order was made under s983A CA, ASIC or a person affected by the order could apply to the court for an order directing that specific amounts in the frozen account be paid to ASIC or its nominee (s983D CA). This order could also include direction to ASIC or its nominee that the money be paid into a separate account, or that ASIC or its nominee be authorized to prepare a scheme for distributing the money to persons who claim and are entitled to the money, or that ASIC or its nominee prepare a scheme to apportion the money in the event that there is a shortfall relative to third party entitlements (s983E CA).

Winding up

ASIC itself does not have a specific power to appoint a monitor, receiver, curator or administrator to an AFSL holder in financial difficulties. However, if the AFSL holder is a company, ASIC has the same powers to act as it would in relation to any company which ASIC had reason to believe was insolvent. ASIC has standing to apply to a court for an order under s459A CA that a company be wound up in insolvency (s459P(1) CA).

Moving client accounts

As soon as ASIC became aware of a potential ASX Market Participant failure, it could seek to remedy any damage by assisting immediately to transfer all client accounts to another entity with the cooperation of the ASX. ASIC may do so by exercising its direction power under s798J CA, provided that it is of the opinion that it is necessary or in the public interest to protect people dealing in a financial product or class of financial products.

The market operator may also require the Market Participant to move client positions, where it appears that it is about to fail (Rule 5160 of ASX Operating Rules and ASX 24 Operating Rules, and Rule 9.5 and 5.1 Chi-X Operating Rules).

Other possible measures

ASIC is empowered to seek an order where an AFSL holder has breached the conditions of its AFSL, including the condition imposing minimum financial requirements on the AFSL (s1101B CA). The court is empowered to make such orders as it sees fit, including:

- An order restraining a person from carrying on a business in relation to a financial product or financial service;
- An order appointing a receiver to the property of the AFSL; and
- An order directing a person to do or refrain from doing a specified act, if that

	<p>order is for the purpose of securing compliance with another order issued by the court.</p> <p><i>Compensation arrangements</i></p> <p>An AML holder has to have compensation arrangements in place if Market Participants on that licensed market are effecting transactions on behalf of retail clients that may provide money, property, or authority over property to the Market Participant (s881A CA). An AML holder can satisfy this requirement by having a compensation regime that is approved by the Minister, in which case the Minister must be satisfied that the compensation regime is 'adequate' before approving the regime. Amongst other things, this requires the Minister to form the view that the compensation regime will provide adequate coverage for losses (s885B CA).</p> <p>An AML holder can satisfy this requirement also by joining the National Guarantee Fund (NGF). In practice the sole member of the Securities Exchanges Guarantee Corporation Limited (SEGC) that is the trustee of the NGF is ASX Limited. NGF could be used to meet certain claims which arise from dealings with participants of ASX and, in limited circumstances, participants of ASX Clear Pty Limited (ASX Clear). The NGF is said to be outdated and not adequately address issues which may arise in the current environment of cross-border trading and multiple trading venues. Chi-X has a separate compensation regime in place that has been approved by the Minister. There is no general investor compensation scheme.</p> <p>In addition, there is a requirement that where an AFSL holder is providing financial services to a retail client it is to have in place a compensation arrangement that complies with s912B(2) CA. The purpose of this compensation arrangement is to compensate clients for breaches of AFSL obligations by the AFSL holders or their authorized representatives. Such an arrangement can either be one determined in the CR or be approved by ASIC as an alternative arrangement.</p> <p>Under the CR option, an AFSL holder is required to have adequate professional indemnity insurance (PII) cover. Adequacy is to be determined on the basis of the AFSL holder's liability for claims brought through its external dispute resolution scheme and the nature of the financial services carried on by the AFSL holder, including their volume, the number and kind of clients, the kind of business, and the number of representatives (reg 7.6.02 AAA CR). ASIC notes in RG 126 that to be adequate, the limit of indemnity under the PII should cover a reasonable estimate of retail clients' potential losses. It further notes that losses caused by negligent, fraudulent or dishonest conduct that amounts to a breach of Ch 7 and gives rise to liability to retail clients must be covered.</p> <p>It is up to the AFSL holder to determine and obtain adequate PII for it to meet its obligations under s912B. ASIC considers that to be adequate, a PII policy must have a limit of at least A\$2 million for any one claim and in the aggregate for licensees with total revenue from financial services provided to retail clients of A\$2 million or less. For licensees with total revenue from financial services provided to retail clients greater than A\$2 million, minimum cover should be approximately equal to actual or expected revenue from financial services provided to retail clients (up to a maximum limit of A\$20 million). Some licensees will require a higher limit of indemnity in order for the insurance cover to be adequate. Licensees must retain records of how they determined what amount was adequate for them. ASIC does not as such approve the PII arrangements.</p> <p>With regards to alternative arrangements, ASIC notes in RG 126 that it will only approve arrangements that give no less protection than adequate PI insurance.</p>
Assessment	Fully Implemented
Comments	ASIC has a wide range of powers to deal with an intermediary failure, some of which it

	<p>has used in the past. It also has plans in place to deal with certain scenarios of intermediary failure.</p> <p>Even though the requirement to obtain a PII policy or maintain an alternative compensation arrangement approved by ASIC fulfils the criteria in Key Question 3.(d), it is recommended that the authorities consider the additional investor protection benefits that an investor compensation scheme would bring.</p>
Principles for the Secondary Markets	
Principle 33.	The establishment of trading systems including securities exchanges should be subject to regulatory authorization and oversight.
Description	<p>A financial market is defined by s767A CA as a facility through which:</p> <ul style="list-style-type: none"> • Offers to acquire or dispose of financial products are regularly made or accepted; or • 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: <ul style="list-style-type: none"> ○ The making of offers to acquire or dispose of financial products; or ○ Acceptance of such offers <p>If a person is not licensed, then it must have an exemption from the licensing provisions in order to operate a market. There is no intermediate category of trading system such as has been developed, and is continuing to evolve, in the U.S. and EU. Under the CA the Minister and not ASIC has the authority to grant AMLs (and CSFLs). Once a market operator is licensed, the Minister has the power to disallow changes to the operating rules and to suspend or cancel a license where the licensee is in breach of one or more of its obligations. License applications, rules and procedures are submitted to ASIC which addresses the applicant's compliance with the statutory requirements. It then forwards the application to the Minister. ASIC is required to advise the Minister about the application, who must have regard to ASIC's advice (among other things) when making his/her decision.</p> <p>All the matters itemized by IOSCO in this Principle for consideration by the regulator before a license is granted are considered by ASIC and form part of its advice to the Minister. The mandatory requirements about which the Minister must be satisfied before granting a license also cover areas not set out in this Principle. An AML applicant is required to submit detailed evidence to support its competence to operate the relevant market and to meet its obligations under the license. The Minister must also be satisfied that granting the license would be in the national interest.</p> <p>Alternative criteria may be applied to an application from an entity that is authorized as the operator of a market in a foreign country and has its principal place of business in that foreign country. The purpose of these alternative criteria is to recognize that, where a market is already regulated in its home country under regulation equivalent to that in Australia, the duplication of such requirements is unnecessary and could discourage such markets from offering services in Australia.</p> <p>As regards a CSFL the application will be examined to determine whether the CSFL holder meets its obligations. For instance, if a CSFL holder assumes principal risk, in order to provide the facility's services effectively it will need to demonstrate that it will have sufficient liquid funds to meet any reasonably foreseeable circumstances in which it will be obliged to complete a transaction. In addition, the RBA has established Financial Stability Standards (FSS) with which a CSFL holder acting as a central counterparty and/or a settlement facility must comply. Each standard includes detailed obligations for CSFL holders designed to reduce systemic risk, such as requirements for certainty of title, principal risk and settlement finality. The Minister and ASIC have broad powers to give a CSFL holder a direction to do things to promote compliance by</p>

the CSFL holder with its obligations.

On an ongoing basis the Minister can impose conditions on a license holder and vary or revoke those conditions. As a result of a new power to write rules granted to ASIC by an amendment to the CA, it has made Market Integrity Rules (MIR) dealing with activities and conduct in relation to licensed financial markets and their participants, which impose ongoing obligations on the market operators. This power however requires the Minister to approve the rules and the Parliament to approve them by negative resolution. AML holders continue to be responsible for the operation of their markets and for monitoring and enforcing compliance with those operating rules that had not been subsumed in the MIRs. These are largely limited to matters concerning order handling, systems and controls issues and membership application criteria and the Listing Rules including the continuous disclosure obligations on listed companies. More significant rules including those concerning various practices which constitute market abuse were transferred to the ASIC monitored and enforced MIRs.

Ongoing supervision by ASIC is discussed further in Principles 9 and 34. An AML holder is required to have adequate measures to address disorderly trading conditions such as powers and procedures to temporarily halt trading. ASIC has a general power of direction to market operators. To deal with any contravening conduct that is detected, ASIC has the power to cancel or suspend the AFSL of an exchange member. ASIC also has powers to act in respect of contravening conduct by an AML holder. The Minister may cancel or suspend the license of an AML holder if he/she considers the AML holder has breached an obligation as a license holder. As part of its supervision of participants under the ASX MIR and Chi-X MIR, ASIC can direct Market Participants to immediately suspend, limit or prohibit the conduct of Automated Order Processing (AOP). ASIC has formed an internal team for significant and/or unexplained market events or disruptions - Significant Market Event Response Team (SMERT) that enacts internal policy and procedures to coordinate an appropriate response with AML and CSFL holders, participants and media. ASIC assesses an applicant's outsourcing arrangements, if applicable, when reviewing an AML application and on an ongoing basis by way of annual assessments including reviewing all relevant books and records.

An application for an AML must, within its rules section, deal with the class or classes of financial products that are to be dealt with on the licensed market by participants, including:

- a description of the nature of each class of financial product; and
- for a class of derivatives, if most of the terms of the arrangement constituting the derivative are determined in advance by the AML holder:
 - the standard terms of the arrangement that constitutes the derivative; and
 - a description of the asset, rate, index, commodity or other thing from which the amount of the consideration or the value of the arrangement is ultimately determined or derived, or by reference to which it varies.

ASIC considers whether, in light of the features of the market, the rules ensure that the market is fair, orderly and transparent, and whether they mean required regulatory outcomes are achieved, for example, by minimizing the risk of price manipulation or other abusive trading conduct. New and amended rules are subject to the ministerial approval process as noted above.

As regards new products, an AML holder is required to have procedures in place which seek to ensure that it adequately considers product design, technology requirements and trading conditions before a decision is made to admit a product to trading status on its market. It must also consider the issues which ASIC in turn considers when an application has been made. When ASIC and subsequently the Minister consider an application to admit a new product to trading, they consider among other things the

market's structure and participants and the nature of the activities to be conducted on the market. When ASIC does an annual assessment of the AML holder, it may check whether the market operator adhered to those procedures when it admitted new products.

As part of reviewing an application for an AML and providing advice to the Minister, ASIC will look at the rules and procedures to assess whether they provide for fair access including whether:

- the participants are providing financial services to other people to execute trades through the market;
- the participants will trade in financial products through the market for retail or wholesale clients; and
- the participants will also be participants in other financial markets

The fairness of order execution procedures is evaluated by ASIC as part of the licensing process. Execution arrangements are set out in the application, and are checked by ASIC to see if they are consistent with securities regulation and if they will be applied fairly. These include the new Competition MIRs which require market participants to ensure that their order management and routing procedures secure the precedence of client orders, prevent front running of client orders and reasonably seek to achieve best execution for clients. An applicant may be required, in support of its application, to provide evidence of testing of the market's systems and processes. ASIC also considers the technology to be used in operating the market and whether it is conducive to a fair, orderly and transparent market. When considering an application, ASIC may request that the market operator has an external independent expert firm verify or attest that systems are reliable and adequate to meet the required standard. Ongoing oversight by ASIC includes satisfying itself that the operator continues to meet its obligation by, for example, applying its order routing procedures fairly and in a way not inconsistent with relevant securities regulation. For example, under Part 5.6 of the ASX MIRs, a market participant which uses ASX system for automated order processing must employ automated filters and ensure that such use does not interfere with the efficiency and integrity of the market or the proper functioning of the trading platform.

If ASIC considers there is a need it will review trade matching or execution algorithms for fairness. ASIC does not generally monitor the ongoing use of the actual algorithms themselves, but it does check the policies and controls that go towards ensuring the algorithms work in a fair and orderly manner, with an objective of preventing a disorderly market. How the operating rules and procedures (including order routing procedures) are disclosed to market participants will depend on the nature of the market. Generally, they are made publicly available. ASX, as a large market open to retail investors, discloses them publicly on its website. A smaller market with fewer participants and only wholesale customers will disclose them to participants, but not necessarily publicly. The operating rules and procedures of a licensed market must provide for the recording and effective disclosure of transactions. In addition, before granting an AML the Minister can take into account the ability to provide completed trade information.

ASIC's Financial Market Infrastructure team has the primary responsibility for assessing whether the applicant has operating rules and procedures that will ensure that the market will operate in a fair, orderly and transparent manner. It conducts trade surveillance to identify serious market misconduct (including insider trading and market manipulation). As described under Principle 12 it has systems and bespoke surveillance tools which reconstruct trading activity on a post-trade and real-time basis. The data used by ASIC Market Surveillance team is provided by ASX and Chi-X under the terms of the MIR. Data is live, in electronic form. The rule sets out a breakdown of

	<p>the various data fields that are required. The information needs to be provided to ASIC in a specified format and comply with data security requirements. ASX and Chi-X are required to re-deliver the data if there is a telecommunication disruption.</p> <p>If ASIC requires additional information a license holder has an obligation to provide it, In turn, an AML holder can also obtain records from the market participants themselves, pursuant to the operating rules. ASX Operating Rules provide that a market participant is required to maintain its records in a form readily accessible to the ASX. If the records have been properly maintained, ASIC can use them to reconstruct trading activity within a reasonable time. In ASIC's view the system meets its operational requirements regarding aggregation and analysis while providing appropriate safeguards as regards confidentiality. In addition to providing data and analytics to ASIC's Market Surveillance team, the system is designed to make available information that enables an AML holder to carry out all its obligations, including to have adequate arrangements for monitoring the conduct of participants on or in relation to the market and enforcing compliance with the operating rules. As regards pre- and post-trade transparency requirements to enable market participants to monitor and manage risk, the approach is the same as for market transparency generally and is described under Principle 35.</p>
Assessment	Fully Implemented
Comments	<p>The CA definition of a financial market is very broad. As a result of the definition ASIC has issued AMLs to 11 Australian entities and 6 overseas based entities, five of which are exchanges in their home jurisdictions. Several of the Australian entities do not provide for the execution of trades on their facilities (which in most jurisdictions would be regarded as an essential element in the definition of a financial market or exchange) but rather merely for the posting of bids and offers and/or the publishing of trades completed bilaterally in the OTC market. A further 19 entities have been given exempt status – often globally recognized inter-dealer brokers and non-exchange trading platforms, foreign based, and providing services to wholesale users in foreign exchange, interest rate and currency derivatives and bond trading. A further 104 entities, many Australia based, operating low-volume (the limit is A\$500,000 per annum) semi-private markets (e.g., for employees to trade the company's shares) have also been exempted.</p> <p>At the same time, as discussed in Principle 35, dark pool operators and brokers operating electronic internal crossing networks, which run order books just as do exchanges, are regulated as AFSL holders. As part of the current work on market infrastructure issues discussed under Principle 35 the authorities might wish to consider amending the definition to better reflect the emerging international consensus on what constitutes a financial market as distinct from a broker or a dealer. An alternative, or complementary approach, would be to develop a definition of an intermediate category of trading system, with some of the responsibilities of an exchange but with some of the flexibility accorded to a broker-dealer operated trading platform, such as has been developed, and is continuing to evolve, in the US and EU.</p> <p>It is not clear whether the regulation of market infrastructure providers such as exchanges and clearing and settlement facilities is as efficient as it should be. It is a two stage process whereby the license holder or prospective license holder negotiates with ASIC the terms of an application, the details of its operating rules and any subsequent changes to them which ASIC then submits to the Minister with a recommendation. ASIC and the applicant or license holder have to await the Minister's decision as to whether to accept or reject the submission. This is particularly the case in light of the increased pace of innovation and change in trading practices, the growing inter-connectivity of Australian markets with those in other major financial centers in the Asia-Pacific region and beyond, and the growth in the complexity of the risk analysis needed to assess such changes from a market integrity and systemic risk perspective. It also creates difficulties for market operators in a multi-market environment (but where</p>

	<p>some market operators may, for technical and legal reasons, be able to operate outside the confines of the financial markets regulatory framework) that need to get a product to market before others have generated early innovator superior profits (perhaps in the OTC derivatives market). No changes have been made since 2006, and the recommendation made then still stands, that consideration should be given to transferring to ASIC the power to license market operators and clearing and settlement facilities, and to approve their rules.</p>
<p>Principle 34.</p>	<p>There should be ongoing regulatory supervision of exchanges and trading systems which should aim to ensure that the integrity of trading is maintained through fair and equitable rules that strike an appropriate balance between the demands of different market participants.</p>
<p>Description</p>	<p>On 1 August 2010 ASIC assumed primary responsibility for market surveillance from the exchanges in respect of secondary trading. Its systems and processes are calibrated to each particular market and the level of oversight it warrants. The SMARTS automated trade surveillance system has the ability to reconstruct trading activity instantaneously in listed instruments across markets, participants and clients. ASIC and the relevant market operator work together to monitor the conduct of market participants, to assess their compliance and to conduct on-site visits to Market Participants. ASIC is engaged in ongoing dialogue with market operators such as ASX to ensure cooperation on managing supervision and has established protocols with market operators on the monitoring and enforcement of MIRs and market operating rules to minimize any duplication.</p> <p>Monitoring of Market Participants is carried out primarily by the ASIC Participant Relationship team (a sub-team within MPS). Referrals by ASX and Chi-X may also be received by the Market Analysis Team while a complaint about a participant may be referred from the MBR. Since the change to ASIC market supervision, participants have more engagement with ASIC in their day-to-day operations. ASIC is building good industry networks with them. ASIC has also become involved in potential market misconduct enquiries at an earlier stage, reducing the time taken to commence investigations into suspicious market conduct. Since taking over market supervision ASIC has on a number of occasions engaged in dialogue with Market Participants directly to deal with trading issues. This preventative and proactive approach assists ASIC in improving participant conduct and preventing potential misconduct.</p> <p>While the function of supervising licensed domestic financial markets is now ASIC's, AML holders continue to monitor trading information and unusual price and volume movements to ensure their participants are complying with their operating rules. To this end market operators have their own compliance units. ASX Compliance Pty Limited (ASX Compliance) is a wholly owned, independently managed subsidiary within the ASX Group that provides compliance and enforcement services to the various ASX Group entities that operate markets or clearing and settlement facilities. ASX Compliance has been delegated authority to make certain compliance and enforcement decisions on behalf of the relevant ASX licensee under its Operating Rules. It is divided into three functional units: Listings, Participants and the Executive Office.</p> <p>The Listing unit is responsible for processing listing applications and enforcing compliance with the listing rules. The Participant unit is responsible for processing applications for admission as a Market or Clearing and Settlement Participant, and enforcing compliance with the Operating Rules. The Executive Office is responsible for bringing disciplinary action against Market and Clearing and Settlement Participants for breaches of ASX's Operating Rules. If an AML holder, through its market surveillance systems (or otherwise), has reason to suspect that a person has committed or is about to commit a significant contravention of the market's operating rules or the Act, the AML holder must advise ASIC, providing the name of the person, details of the contravention and saying why the licensee believes there has been or is about to be a contravention.</p>

In particular, should ASX identify possible breaches of the continuous disclosure provisions by listed companies these are referred to ASIC. The AML holder is also required to advise ASIC where the licensee has taken any kind of disciplinary action against a Market Participant.

ASIC, in the course of conducting its annual assessment of the AML holder examines the AML holder's surveillance practices and procedures. Under the Competition MIRs AML holders have further reporting requirements which assist ASIC in detecting market misconduct. For example, an AML holder is required to notify ASIC of a transaction executed on the market within the extreme cancellation range (ECR) as determined for that market. The ECR for a stock is determined by ASIC and is a published number. It is based on the share price. For example, in a share priced between A\$10 and A\$20 it is a trade priced at 30 percent or more away from the opening price. Such trades will be cancelled if detected within 30 minutes of execution. Market operator must also have adequate controls to prevent an order for which the price is above the maximum or below the minimum threshold set by the operator for the stock from being executed (anomalous order threshold). ASIC can require an operator to amend the threshold if ASIC believes it to be inappropriate. Market Participants continue to have obligations under the MIRs for their market actions and are required to have and maintain the necessary resources to ensure that orders that they enter into the market do not interfere with the efficiency and integrity of the market, and to act in a manner which maintains a fair and orderly market. ASIC expects that Market Participants will have in place risk filters when submitting orders into the market, based on their system capabilities and their regulatory risk profile.

The table below summarizes the alerts, enquiries and deterrence team referrals from ASIC's market supervision between 1 January and 30 June 2011, and includes the data for the first five months of supervision undertaken by ASIC from 1 August to 31 December 2010.

ASIC Market Supervision

Outcomes (number of matters)	1 Jan--30 June 2011	1 Aug--31 Dec 2010
Total number of alerts	23,494	28,512
Preliminary enquiries	121	91
Formal enquiries	2	40
Deterrence referrals	35	17

Source: ASIC

It is noteworthy that automated surveillance generates many more alerts than are escalated to enquiries or referrals to deterrence. This is not unusual in such systems and can have many causes. Only some will be related to the difficulty of evidencing that persons dealt on the basis of inside information or were intent on manipulating the market price of a security or securities. ASIC is constantly seeking to refine the system to reduce the number of "false positives".

As set out under Principle 9, ASIC conducts annual assessments of how well an AML (or CSFL) holder is complying with its obligations as a licensee, but may also make an ad hoc request at any time in the course of discharging its obligations under the CA. The statutory position regarding rule changes is as set out under Principle 9. For changes to operating procedures different provisions apply. ASIC has put in place a Competition MIR that requires AML holders to notify ASIC of material changes to their procedures within a reasonable time before adopting the change but approval by the Minister is not required.

Intervention by the regulator

	<p>In the case of an AML the power to intervene resides largely with the Minister and not ASIC. The Minister has a range of options available if there is a concern that the exchange is unable to comply with its license obligations. These include the power of the Minister to give directions to the AML holder if he considers that the licensee is not meeting its license obligations. If the AML holder does not comply with the Minister's direction, it is open to ASIC to apply to the court for an order that the AML holder complies with the direction. The Minister also has the power to require an AML holder to provide a special report on specific matters to ASIC. The Minister can also require the special report to be audited by ASIC or a suitably qualified person specified by the Minister. ASIC can also give direction to an AML holder, where it is in the public interest to protect persons dealing in a financial product or class of financial product, to suspend dealings in that financial product. ASIC can also give some other directions in relation to dealings. The direction has effect for 21 days and if the AML holder does not comply, ASIC can apply to the court for an order to enforce the direction. An AML holder can require ASIC to refer the matter to the Minister, who can require ASIC to revoke or suspend the direction. ASIC can also give a direction to the operator of a clearing and settlement facility with which the AML holder has arrangements, not to act inconsistently with the direction given to the AML holder.</p> <p>If the Minister considers that the AML holder has breached or is in breach of its license obligations, the Minister may issue a notice requiring the AML holder to show cause at a hearing why the license should not be cancelled or suspended. Australian Derivatives Exchange Limited ('ADX') had its AML revoked in 2001. This was due to ASIC raising concerns with ADX about its ability to operate a fair and orderly market while in continuing breach of the forward cash requirements of its license.</p>
Assessment	Fully Implemented
Comments	<p>The anomalous order thresholds and extreme cancellation ranges, and the obligations on market operators to (i) prevent anomalous orders from being executed; and (ii) cancel orders in the ECR are a sophisticated response to events such as the "flash crash" in the NYSE on 6 May 2010. It will be important to ensure that their application is open and transparent to avoid similar situations as in the flash crash where trades at 60 percent or more away from the reference price were cancelled, but it remains unclear who the "winners and losers" in that process were and whether the outcome was "fair".</p> <p>The current position, where Chi-X has been offering a competing platform to ASX in ASX's top 200 stocks has been operational for only a few months – although all parties had up to four years to prepare. It is thus described by ASIC as being in a transitional phase. However, there appear to be a not insubstantial number of outstanding issues and situations where it is not yet clear to all those involved in the markets where the responsibility for monitoring and enforcing particular rules falls as between ASIC, ASX and Chi-X. This could lead to uncertainty among licensees as to which rulebook they should look to for compliance. Resolving any confusion should be prioritized in order to create certainty and reduce inefficiencies within firms and between ASIC and the AML and CSFL holders. Currently the pace of resolution may have slowed. For example, rules on the segregation of client money is ASIC's responsibility but some relevant record keeping rules may still reside with the AMLs. Another example concerns market surveillance, which is ASIC's responsibility but ASX is responsible for enforcing the continuous disclosure obligations on its listed companies, including derogation from the requirement to immediately publish price sensitive information. An appearance of a leak in this process may result in ASIC mounting an insider dealing investigation which will generally include questions as to whether ASX's rules had been breached.</p>
Principle 35.	Regulation should promote transparency of trading.
Description	Under the principles based approach to regulation the overarching statutory obligation on an AML holder is to do all things necessary to ensure that the market is fair, orderly

and transparent. The operating rules are required to address the execution of orders while the operating procedures are required to address the recording and effective disclosure of transactions. Disclosure to participants is covered by the operating rules of the market. Where appropriate, ASIC inserts additional provisions in the MIR for a market. For example, Part 3.4 of the ASX 24 MIRs deals with pre-trade transparency for block orders in the ASX 24 (derivatives) market. By contrast, there are four AML holders that are operating specialized over-the-counter markets that allow parties to effectively trade 'off market'. While indicative quoting and indications of interest may be displayed on those markets, all deals are bilateral and off-screen. These markets involve principal to principal transactions between wholesale investors, and so, in ASICs view, there is not the same need to impose a regime of real-time transparency.

Pre-trade transparency

The Competition MIRs (which currently only apply to ASX and Chi-X) require all market operators to make pre-trade and post-trade information available to a person who seeks to access that information on reasonable commercial terms, and on a non-discriminatory basis. Market participants (exchange members) must not (subject to certain exceptions) enter into a transaction in an equity market product unless the order is first pre-trade transparent on an order book of a licensed market. The AML holder must make pre-trade information available immediately after it receives it to all persons it has arrangements with to make the information available, subject to the exceptions in the Competition MIRs. For orders received outside trading hours, the AML holder must make pre-trade information available no later than the time trading next resumes.

AML holders must take reasonable steps to ensure the pre-trade information is and remains complete, accurate and up-to-date. Pre-trade information includes: order date; order time; product identification; volume; order side (that is, buy or sell); price and currency. The exceptions to the rule on pre-trade transparency are generally internationally recognized as appropriate; namely block trades, large portfolio trades, trades at or within the spread (broker internally crossed trades), permitted trades during the pre- and post-trading hours periods and out of hours trades (where one party has to be outside Australia). ASIC approach to derogations from pre-trade transparency is to permit them if price formation is not adversely affected. ASIC also looks to whether the benefit of price transparency outweighs the cost to investors in the form of price impacts. ASIC's approach to making Competition MIRs on pre-trade transparency has been as an interim measure, to harmonize those of new entrant Chi-X with ASX's existing pre-trade transparency exceptions. The current derogations are clear and evidence based. In assessing the need for their continuation or if necessary, to prescribe alternatives, ASIC believes that it can obtain sufficient data to make informed decisions based on its powers to obtain information and that it has the resources at its disposal to conduct the necessary analysis. It is currently estimated that around 27 percent of orders in Australian equities are not pre-trade transparent although dark pools are estimated to account for less than one quarter of that amount (i.e., less than 5 percent overall). ASIC intends to amend the block trading exception to align it with the liquidity of the market in a particular stock. Overall the size limit will be reduced.

Post-trade transparency

Post-trade information for off-exchange transactions in exchange listed securities must be reported to a market operator. The post-trade transparency rules thus capture capture all transactions, including orders executed in dark pools and those executed on broker crossing networks. An AML holder must make post-trade information available to all persons who have entered into an arrangement with it to access that information. It must take reasonable steps to ensure the post-trade information is and remains complete, accurate and up-to-date. For orders executed or reported during the trading hours this must be provided continuously and in real-time. For any transactions executed or reported outside of trading hours, the information must be provided before

the next trading day. Post-trade information includes: trade execution date; trading time; product identification; volume; price; currency; trade cancellation indicator (unique notation or code); and original trade date (for cancelled transactions). Exceptions for real time post trade transparency include large principal transactions in which the market participant acts as either buyer or seller and remains on-risk. The Competition MIRs support the provision of trade information to enable data consolidators to provide a consolidated service. Data consolidators are expected to adhere to minimum operating standards which govern the consolidator's function and operation in the market. These standards aim to ensure, among other things, completeness and quality of information and robustness and reliance of service. A market operator is required to make available comprehensive trading information on its publicly available website within 20 minutes of the completed transaction free of charge. Markets not covered by the Competition MIRs (i.e., currently other than ASX and Chi-X) have rules which require the provision of this type of information to the market.

The extent of dark pools in Australia

The only AML holder operating a dark pool in Australia is ASX. It is covered by the Competition MIRs and ASIC has full access to its trading information. Most of the dark pools operating in Australia are broker crossing systems though at least two specialized dark pool operators are active. ASIC has offered dark pool operators the option of holding AFSLs and becoming members of a licensed market as an alternative to applying for an AML. One such operator was expected to become an AML holder when it opened for business but instead chose the alternative provided by ASIC.

ASIC is aware of the recent trend for smaller trades to shift into dark pools and the risk that if too much liquidity shifts, the quality of the price formation process on-market will deteriorate (resulting in wider spreads and worse prices for trades done both on pre-trade transparent markets and in the dark). Accordingly, ASIC has been closely monitoring the development of dark trading and dark orders. The Competition MIRs imposed a new reporting requirement for market participants that operate crossing systems outside markets. They must lodge an initial report and a monthly report containing crossing system trading information on relevant equity market products. This is designed to facilitate ASIC's market analysis and consideration of alternative options for regulating such crossings. It enables ASIC to monitor the development of dark trading and dark orders. ASIC monitors trading via those reporting requirements imposed on crossing systems, analyzing the monthly reports of trading activity for trends. ASIC receives full details of the nature of crossing systems before they commence operating. ASIC is also currently consulting on an additional obligation for crossing systems and operators of dark pools to provide meaningful price improvement over the national best bid and offer. This is expected to encourage more trading to occur on pre-trade transparent order books.

Order priority

ASIC's position is that transparent orders should take priority over dark orders, although ASIC is aware that under certain circumstances dark orders should be permitted as there are legitimate reasons to allow such orders. A market operator must ensure that a fully hidden order on an order book does not have time priority over an order for the same equity market product on the same order book that is either fully or partly pre-trade transparent. Fully hidden orders may, however, have price priority.

Operational transparency

Market participants, including those that operate dark pools, must disclose certain information about their execution arrangements to clients in accordance with the best execution rules. A licensed market's operating rules must deal with (among other things) execution of orders and the way in which disorderly trading conditions are to be dealt with. All licensed markets, including those that offer dark orders, must provide

	information in their operating rules and procedures about how orders are handled and executed. The rules and procedures are publicly available.
Assessment	Fully Implemented
Comments	<p>There appears to be very little OTC trading in exchange listed equities by brokers or dealers, unlike in equity markets in Europe and the U.S. This is primarily a result of ASIC's interpretation of the definition of a financial market in the CA whereby it deems an AFSL holder which trades for clients in ASX stocks while not an ASX Market Participant (member) as operating a financial market for which an AML is necessary. As long as the AFSL holder provides such a service, including internalizing order flow via an automated crossing system, but reports the trades to ASX (or Chi-X) even via another member, the firm can carry on this business under its AFSL license.</p> <p>As a result the debate in Australia on market structure changes has not polarized around the dealer versus broker model or on-exchange versus OTC advocates as it has in the EU and the US. It has instead focused on the issues around "lit" versus "dark" markets, complex issues around the benefits and dangers of high frequency trading and how to balance the needs of various categories of investor, particularly retail (and small institutional) investors in a multi-market highly automated, increasingly algorithm driven market place.</p> <p>ASIC's analytical work on dark pools, dark liquidity and high frequency trading is well regarded in the industry. While opinions differ as to ASIC's conclusions to date there appears to be a consistent view that the work is based on a sufficient amount of accurate data and has been properly and impartially carried out having regard to ASICs regulatory priorities to secure fair, orderly and transparent markets. In April 2012 ASIC published a series of proposals for change. These include:</p> <ul style="list-style-type: none"> • Updating rule on the testing of algorithms and annual review of systems; • Additional minimum standards for direct market access; • Tier 'block size' exception (currently A\$1m) by reference to liquidity of stocks (range from A\$200,000 to A\$1m); and • Meaningful price improvement requirement for dark trades below block size <p>The announcement included a statement that ASIC will consult later in 2012 on new general 'market operator-like' obligations to apply to operators of dark pools and a warning that if dark liquidity below 'block size' grows by 50 percent in the next 3 years, ASIC will impose a A\$50,000 threshold for dark trades arising from passive (limit) orders.</p>
Principle 36.	Regulation should be designed to detect and deter manipulation and other unfair trading practices.
Description	<p>Market or price manipulation</p> <p>Market manipulation, market cornering, misleading statements, insider trading, front running and other fraudulent or deceptive conduct are prohibited under Part 7.10 of the CA. Prohibited conduct includes:</p> <ul style="list-style-type: none"> • Market manipulation; • False trading and market rigging (creating a false or misleading appearance of active trading etc.); • Artificially maintaining trading price; • Dissemination of information about illegal transactions; • Insider trading; • False or misleading statements; • Inducing persons to deal; and

- Dishonest conduct

Misleading or deceptive conduct

With the exception of misleading or deceptive conduct, which attracts only civil liability, breaches of these provisions attract both criminal prosecutions and civil ramifications. These provisions apply to trading of financial products offered on a financial market operated in Australia. In relation to the detection of such conduct, if an AML holder has reason to suspect that a person has committed, or is about to commit, a significant contravention of the market's operating rules or the CA, then the AML holder must advise ASIC. The AML holder is to give ASIC the name of the person, details of the contravention and why the AML holder believes there has been or is about to be a contravention. In addition to ASIC's role in supervising compliance by market participants with the market misconduct provisions of the CA and with the AFSL provisions, ASIC has made a number of MIRs for particular markets which contain similar prohibitions to ensure that the intermediary can be held responsible as well as the client. Now that ASIC is responsible for supervising trading activities and market participant conduct there are MIRs to prohibit all forms of market manipulation such as entering orders without an intent to trade, wash trades, withholding orders with an intent to obtain a counterparty, withdrawing orders for the benefit of others, and post-allocation.

Penalties

Criminal penalties range from A\$495,000 to A\$950,000 or imprisonment for ten years, or both. Civil penalties may be imposed after a court declares a civil penalty provision has been contravened. Civil penalties are of two types: a court can order person to pay a fine of up to A\$200,000 (or up to A\$1 million for a corporation) and/or, it can order compensation to be paid to a person (including a corporation) for damage suffered due to the contravention. MIRs have the force of law and therefore a court may order a person to pay a fine for a failure to comply with a MIR. For each form of market manipulation and prohibited trading activities the relevant MIR specifies a maximum penalty amount that a court can order a person to pay for contravening that rule. The penalties range from A\$100,000 to A\$1 million. The various offenses are clearly defined in law.

Misleading information

A person must not make a statement if the statement or information is false or misleading or likely to be so, and the statement is likely to induce persons to apply for or dispose of financial products or affect the price for trading in financial products on a financial market. Contravention enables affected persons to take civil action on their own behalf to recover the amount of their loss or damage.

Insider trading

It is an offence for a person with inside information to acquire, or dispose of, financial products or procure another person to do so. Contravention of this section attracts both civil and criminal penalties. In the case of civil penalties, a court can order a person to pay a fine of A\$200,000 or a corporation a fine of up to A\$1 million. Criminal penalties range from A\$495,000 to A\$4,950,000 or imprisonment for ten years, or both.

Front running

ASIC has made MIRs, currently covering ASX and Chi-X, in relation to treating clients' orders with fairness and priority. Failure to give priority to client orders would be a breach. If the sequence of entry of orders into the trading system is not clearly established by the time the orders were received, and one of the orders is for the market participant's own trading account, the market participant must give preference to

the order of a client over any order for the market participant's own account. Failure to comply with these MIRs attracts a penalty of up to A\$1 million. See below for further detail on the enforcement of the MIRs. ASIC can also take action under its AFSL regime. The CA imposes a specific requirement on an AFSL holder in relation to giving priority to client orders. These prohibitions do not apply if the client's instructions are subject to a condition about price and that condition has not been met or where the regulations allow such a transaction. It is an offence punishable by a fine of A\$2,750 or imprisonment of up to six months or both, to breach this section.

Other fraudulent or deceptive conduct and market abuse is prosecuted under the Crimes Act.

Enforcement methodology

The regulatory approach to detect and deter such conduct includes an effective and appropriate combination of mechanisms including direct real-time surveillance, securities listing or product design requirements, audit trail requirements, quotation display rules, and market halts complemented by enforcement of the law and application of significant civil and criminal penalties. In combination these act as an effective deterrent. Effective order handling rules, robust listing requirements and quotation display rules and provision for market halts limit the risk of misconduct and its likely effects. ASIC believes that the combination of administrative civil and criminal sanctions is effective, proportionate and dissuasive.

AML holders are required to maintain systems that effectively record and disclose transactions and ASIC has its own systems for market surveillance centered on the SMART system as described under Principles 12 and 33. An AML holder is also required to report cases where it has reason to suspect that a person has committed, is committing, or is about to commit a significant contravention of the market's operating rules or the CA. There are a number of trade surveillance alerts (trigger mechanisms) set up in SMARTS which are triggered once set parameters are breached; these alerts are used as indicators of unusual trading activities. Preliminary enquiries are conducted where ASIC's market surveillance analysts are not able to explain an alert or a series of alerts by reference to available market information, including media, internet chat sites, broker research and dialogue with brokers. Should preliminary enquiries suggest further work is required, ASIC can use its compulsory powers under the CA and ASIC Act to conduct formal enquiries of participants, clients, listed entities, and corporate and other advisers.

Besides the use of alerts from SMARTS, ASIC also uses direct dialogue with market participants to discuss any trading issues or concerns. Both ASIC and the relevant market operator conduct periodic on-site visits to market participants. From the on-site visits, should ASIC's review of documents and records reveal evidence of suspicious trading, further inquiries can be made. ASIC cannot tap phones but it can obtain records of phone calls made using its powers to compel the production of records from any person, including telecoms providers. Market abuse cases may be supported on this degree of circumstantial evidence as to who spoke to whom and when.

Cooperation between ASIC and CDPP

The working relationship between ASIC and the office of the Commonwealth Director of Public Prosecutions (CDPP) appears to be effective and efficient. According to a senior official at the CDPP it is the model for the relationship between the CDPP and other investigatory government agencies. The CDPP is a purely prosecutorial authority. ASIC sends briefs to the CDPP which, on the evidence provided, decides whether to mount a prosecution based on criteria set out in the Prosecution Policy of the Commonwealth – a public document. Under the Prosecution Policy there is a two-stage test that must be satisfied:

	<ul style="list-style-type: none"> • there must be sufficient evidence to prosecute the case; and • it must be evident from the facts of the case, and all the surrounding circumstances, that the prosecution would be in the public interest. <p>There is an MoU between ASIC and the CDPP which sets their mutual understanding of the importance of criminal sanctions. The CDPP has a designated contact person for ASIC. There is an agreed format setting out the evidence that ASIC must gather if the CDPP is to be able to bring a prosecution. The CDPP is responsive to ASIC’s policy priorities as regards prosecutions. Currently, for example, ASIC prioritizes securities market focused cases. The CDPP has set up a Market Focus group in response. The CDPP notes that it has a high success rate in prosecutions; 90 percent in summary offences and 90-100 percent in the more serious indictable offences. Most offences in this area are capable of prosecution under civil or criminal provisions. The CDPP advises ASIC on where, in its view, the public interest lies in the choice of action. The CDPP and the judiciary appear fully cognizant of the need to pursue “white collar crime” as vigorously as other forms of crime.</p> <p>Cross market trading</p> <p>Cross market trading abuses are primarily addressed through information sharing between different markets and with ASIC and by ASIC’s supervisory oversight. AML holders are required to have in place procedures for the exchange of appropriate information with clearing and settlement facilities, other financial markets and ASIC. In the context of trading of the same financial product in multiple markets such as on ASX and Chi-X, the Competition MIRs require that market operators make available to each other via an electronic data feed notifications relating, among other things, to pre- and post trade information and the status of trading in each equity product.</p> <p>Foreign linkages</p> <p>ASICs cooperation and information sharing arrangements with regulators in other jurisdictions are set out in Principles 13-15. Market operators such as the ASX have also entered into MoUs with other national exchanges. ASX has MoUs with the national exchanges in Hong Kong, Indonesia, Korea, Malaysia, the Philippines, Taiwan, Tokyo, Thailand, and Singapore. The ASX is also a member of the Intermarket Surveillance Group.</p> <p>Futures and commodities markets</p> <p>ASX monitors client position limits across all ASX derivatives contracts relying on the Daily Beneficial Ownership Reports (DBOR) received from Market Participants. These reports show the underlying holder of each position, and allow ASX to track holdings across multiple participants. Any undesirable buildup of positions can then be identified and dealt with. ASX has Operating Rules which allow it to take action to correct an ‘undesirable situation or practice’ which might threaten the fair, orderly and transparent trading of its market. These include but are not limited to a squeeze or a settlement price that does not reflect genuine market activity in the underlying market. In respect of any suite of products traded on the ASX 24 trading platform, trading participants are required to lodge with ASX a DBOR containing information regarding the beneficial ownership of every open position in an account as at close of trading. ASX provides ASIC with a copy of these reports, for information.</p>
Assessment	Fully Implemented
Comments	
Principle 37.	Regulation should aim to ensure the proper management of large exposures, default risk and market disruption.

Description	<p>Under the Australian regulatory system, open positions and the risks associated with exposures from open positions are dealt with through the following:</p> <ul style="list-style-type: none"> • obligations imposed on CSFL holders; • prudential requirements imposed on market intermediaries; and • MIRs. <p>CSFL holders are regulated and monitored by ASIC and by the RBA (in relation to financial stability). CSFL holders, in turn, are required to meet obligations imposed by the CA and financial stability obligations imposed under Financial Stability Standards (FSS) promulgated by the RBA. CSFL holders' obligations under the CA and the FSS address issues of large exposure risks. The operating rules of a CSFL holder are required to address matters relating to risk. It must have procedures to identify and monitor risks to the facility and develop rules and procedures to address those risks.</p> <p>Role of the Reserve Bank of Australia (RBA)</p> <p>The primary role of the RBA in relation to CSFL holders is in the setting of FSS which are intended to ensure that a CSFL holder conducts its affairs in a way that promotes the overall stability of the Australian financial system as required by the CA. The FSS are broadly similar to the CPSS-IOSCO Recommendations for Securities Settlement Systems and Central Counterparties. The RBA determined its FSS in May 2003, with variations made in June 2005 and February 2009. A CSFL holder must be able to demonstrate compliance with any relevant FSS and ability to do all things necessary to manage systemic risk. Two measures under the FSS for Central Counterparties are relevant to addressing large exposure risk. A CSFL holder is under an ongoing obligation to comply.</p> <p>In addition to setting the FSS, the RBA is required to conduct at least once a year an assessment to determine how well the CSFL holder is meeting its obligations. The RBA's assessment is in addition to the annual assessment that ASIC is required to undertake to assess a CSFL holder's compliance with all the obligations imposed on it other than those for which the RBA is responsible. The CA has therefore clearly delineated between the role of ASIC and the RBA. The RBA and ASIC also entered into a MoU in March 2002. Unlike APRA, which has "step in" powers to take over the running of a failing bank, the RBA (or ASIC) has no such equivalent powers as regards a CSFL. This issue is currently under discussion.</p> <p>Two measures in the FSS are of particular relevance to this principle. Measure 7 requires as a minimum that the risk-control arrangements must provide the CSFL holder as operator of the CCP with a high degree of confidence that the CCP will be able to settle its obligations in the event that the participant with the largest settlement obligations (that is, the largest exposure) cannot meet them. The FSS also include a requirement for the CCP to undertake regular and rigorous stress testing to ensure the adequacy of its risk controls. ASX Clear and ASX Clear (Futures) use daily stress tests to monitor the risks undertaken by individual participants and the adequacy of the CCP's financial resources. Stress test scenarios cover extreme price moves and volatility shifts at the market-wide, sector and individual stock levels. ASX regularly reviews stress-test scenarios and occasionally amends them to reflect current market conditions. A Clearing Participant is required to post additional collateral should stress-test outcomes reveal that the potential loss arising from its positions as at the close of the previous day exceeds its stress-test exposure limit (STEL). The results of these daily stress tests and any calls for additional collateral are reported and reviewed by the RBA. The RBA is also notified of any changes to the stress-test scenarios or available risk resources. The RBA would consider a persistent inability of paid up default resources to cover maximum stress test exposures as a trigger for an increase in total paid up default resources.</p>
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Measure 5 requires settlement to occur with an appropriate DvP arrangement. Austraclear (which settles debt securities and one sided payment obligations arising from derivatives transactions) settles on a DvP Model 1 basis; ASX Settlement (which settles cash equities) settles on a DvP Model 3 basis. No credit exposures arise from these processes. However, a failure to settle in ASX Settlement where this relates to a transaction novated to ASX Clear will crystallize market risk to the CCP. The risk controls discussed above safeguard the CCP against that risk. On an on-going basis, there are several mechanisms through which oversight of the CSFL holder by the RBA is maintained. RBA conducts continuous oversight of CS facilities in respect of stability issues.

Regulation of market intermediaries

The risks posed to the market by large exposures are also addressed through the regulation of market intermediaries by the AML holder (where the intermediary is itself a Market Participant) and ASIC. The large exposure rule of the AML holders requires that additional capital must be held by participants that have large counterparty exposures relative to their liquid capital and large exposures to particular issuers on principal positions in equity and debt securities relative to their liquid capital and relative to the market value of those securities on issue. The requirement to hold additional capital against a principal position in securities arises where the principal position is:

- greater than 25 percent of the Market Participant's liquid capital; or
- for equities, greater than 5 percent of the market capitalization of the listed entity; and
- for debt securities, greater than 10 percent of the total value of the particular debt instrument on issue.

If the above thresholds are exceeded, the additional capital required will be the value of the position that is in excess of the benchmark percentages times a prescribed position risk factor applicable to the position. This is consistent with the Basel approach to the treatment of position risk in the trading book.

ASX Clear also has extensive rules governing the calculation of large exposures to counterparties and issuers in equities, equity related products and foreign exchange as set out in the ASX Capital Liquidity Handbook, Rule S1 Annexure 2.

For derivatives, ASX 24 MIR on Concentration of Risk prescribes that no one client may 'represent such a percentage of trading by the Market Participant as may prejudice or diminish the ability of the Market Participant to meet its obligations under these Rules and at law.' It is not specific in terms of setting a quantitative number. However, in respect of any suite of products traded on the ASX 24 derivatives trading platform, market participants are required to lodge with ASX a daily beneficial ownership report containing information regarding the beneficial ownership of every open position in an account as at close of trading. ASX provides ASIC with a copy of these reports for information.

There are no large exposure rules governing the proper management of large exposures, default risk and market disruption that arise in the course of bilateral transactions involving AFSL holders that are not supervised by APRA and are also not supervised by ASX as Clearing Participants or by ASIC as Market Participants. Such bilateral transactions may include new issue underwriting (where a negative change in market circumstances can leave a firm commitment underwriter heavily overexposed), or other OTC trading in equities, long term derivatives or complex structured products.

Action by an AML or CSFL holder or ASIC

Market Participants are subject to the operating rules and procedures of the AML or CSFL holder, which can also take action if a Market Participant fails to provide

information. If a participant fails to comply with a direction of ASX Clear, it is considered to be an event of default, which gives rise to specified actions and events under the rules. Compelling Market Participants to reduce large positions is within the remit of the CFSL holders. For example, the ASX Clear rules prescribe requirements in respect of initial margin and other margin obligations for derivatives CCP contracts and prescribe consequences if a participant breaches a position limit, an initial margin limit or an exercise limit or capital adequacy requirements. The ASX Clear Rules provide it with powers to prescribe additional returns to be lodged by participants and to impose a secondary capital requirement on a Market Participant to cover unusual levels of operational risk.

In addition to the powers given to ASX Clear in its rules, the general powers, processes and procedures for dealing with contraventions of the Operating Rules within the ASX Group, including the ASX Clear Rules, are set out in the Enforcement and Appeals Rulebook. This rulebook prescribes a range of enforcement action available, depending on the nature and severity of the breach, including censures, monetary penalties, requirements for participants to implement education and compliance programs, or directions against individuals in respect of their role in the business. ASIC can take action if an AFSL holder, that is a participant of a licensed market or CS facility, was carrying a large position and this meant that they no longer satisfied the conditions of their AFSL.

A CSFL holder can communicate information about large exposures to regulators and other market operators. The operating rules of a CSFL holder provide for the exchange of information about large exposures. ASIC's powers to share information within and outside the jurisdiction, including the constraints on that power in some circumstances are as set out in Principles 13-15. The CA and Competition MIRs set out mechanisms for consulting and sharing information, including on trade cancellations, trading suspensions and technical outage problems that may interfere with the fair, orderly or transparent operation of any market. Information sharing arrangements covering areas such as the above apply to markets quoting common products in respect of equity financial products. Currently ASX and Chi-X are the only two markets where such arrangements are in place but the risks on other licensed markets are very small.

The default procedures for participants are included in the CSFL holder's Operating Rules, which are made available to participants. The Operating Rules of the CSFL holder are required to address the detailed handling of defaults. For example, all the Operating Rules of the ASX Group (which holds four out of the five CSFLs) are publicly available via the ASX's website. This website contains any Guidance Notes issued in respect of particular rule obligations, details of waivers previously granted and details of the ASX Tribunal determinations as set out in disciplinary circulars, notices and bulletins. Where clearing and settlement arrangements are not provided by a CSFL holder, the operating rules of the AML holder are expected to address default procedures. In the event of a default, action would be taken by the AML or CFSL holder, as the case may be, in accordance with its Operating Rules, which are contractual obligations.

As for powers to promptly isolate the problem of a failing firm by addressing its open proprietary positions and positions it holds on behalf of customers or otherwise protect customer funds and assets from an intermediary's default under national law, as noted in Principle 32, as soon as ASIC became aware of a potential ASX Market Participant failure, it could seek to remedy any damage by assisting immediately to transfer all client accounts to another entity with the cooperation of the ASX. ASIC may do so by exercising its direction power provided that it is of the opinion that it is necessary or in the public interest to protect people dealing in a financial product or class of financial products. The market operator may also require a Market Participant to move client positions, where it appears that the participant is about to fail. Views were expressed that there are serious constraints within the CA on the power of ASIC (or the clearing

and settlement facility operator) to achieve this desired outcome. On the positive side the Clearing House Electronic Subregister System (CHES) operated by ASX provides for individual client custody accounts which should provide an additional layer of protection in the event of a broker defaulting. Also, the Payment Systems and Netting Act 1998 provides legal certainty for close out netting in financial markets and for netting undertaken in accordance with the rules governing stock and futures exchanges and clearing houses and is compliant with the ISDA Master Netting Agreement.

Short selling on equity market

Under Australian law, naked short selling is prohibited (subject to certain exceptions) while covered short selling is permitted. The CA defines naked short selling as occurring where the seller does not have 'a presently exercisable and unconditional right to vest' certain financial products in the buyer at the time the sale of those products is made. Post the global financial crisis ASIC toughened the rule to require a guarantee of delivery by the seller before the short is executed. In addition, ASX requires settlement of all transactions within three business days (T+3) and imposes fees for 'failed' settlement. The fail fee is calculated as 0.1 percent of the outstanding trade value and is levied on each business day that the shortfall persists. The settlement fail fee has a floor of A\$100 and a cap of A\$5,000 per security per day (which was increased by ASX from a floor of A\$50 and a cap of A\$2000 to further discourage failed settlement). Serious instances of settlement delays may be referred by ASX to the ASX Disciplinary Tribunal. In 2009 ASX also implemented an automatic close out mechanism if the trade has not been settled by T+5. Where the automatic close out mechanism operates, the Settlement Participant must purchase or borrow shares to complete the failed settlement.

There are two types of short sale reporting obligations in Australia:

- Short sale transaction reporting which involves reporting of daily volumes of products that are short sold in the market (gross short sales); and
- Short position reporting which involves reporting where there is a short position.

Sellers are exempt from reporting their short positions where the value of the short position is less than or equal to A\$100,000 and the volume of their short position is less than or equal to 0.01 percent of the total quantity of securities or products in the relevant class. An AFSL holder that makes a short sale on its own behalf or on behalf of another person must report the gross short sales to the market operator by 9 am on the trading day following the transaction. The market operator is then required to publicly disclose the total number of products that have been sold short on a particular day. The public disclosure will be made on the same day that the sales are reported to the market operator.

A person must report their short position in a listed entity to ASIC on or before 9am on the third day after the position was first created. The person must also continue to report their short positions to ASIC for every subsequent trading day that they continue to hold a reportable short position. ASIC then aggregates and publishes this data on its website on T+4.

ASX conducts daily monitoring of settlement failures, levies failure penalties and has enforceable buy-in provisions (T+5). ASX's T+3 settlement failure rate is less than 1 percent, most of which then settles at T+4. ASIC routinely checks short position reports that are lodged with it to detect significant and unusual trends or movements in short positions and takes follow up action where necessary. There is no targeted surveillance. It is therefore not currently possible to measure the accuracy of reported short positions. ASIC is therefore considering plans to evaluate compliance with the short position reporting obligations during future surveillance checks. Regulator-level reporting on settlement fails takes place monthly to ASIC and the RBA. Stock lending takes place via CHES which provides an additional layer of data aggregation and

	<p>control.</p> <p>Some exceptions do exist to allow naked short selling for certain types of transactions. These exceptions have primarily been granted for the purposes of facilitating the efficient and orderly functioning of the market and are consistent with international good practice.</p>
Assessment	Partly Implemented
Comments	<p>In 2006 this principle was rated Partly Implemented because there were no large exposure rules governing the proper management of large exposures, default risk and market disruption that arise in the course of bilateral transactions involving AFSL holders that are not supervised by APRA and are also not supervised by ASX as Clearing Participants or by ASIC as Market Participants. That situation remains unchanged. Within this group of firms are subsidiaries of global investment banks, including Goldman Sachs, Morgan Stanley and Nomura. As noted at page 9, companies within these three groups are Clearing and Market Participants that are subject to related regulatory requirements (including on capital). However, other entities in the three groups may also enter into bilateral transactions. Two of these have been assessed by the FSB as Global Systemically Important Financial Institutions (G-SIFI) which, elsewhere, would be subject to enhanced prudential supervision because of their status.</p> <p>The issue concerning the powers of ASIC or the clearing facility operator to transfer client positions from a failing firm to a viable one should be examined as a matter of urgency.</p>
Principles Relating to Clearing and Settlement	
Principle 38.	Securities settlement systems and central counterparties should be subject to regulatory and supervisory requirements that are designed to ensure that they are fair, effective and efficient and that they reduce systemic risk.
Description	
Assessment	Not assessed.
Comments	