

New market supervision role for ASX

The ASX recently outlined a new operational structure to improve the independence of its market supervisory functions.

The ASX's transformation from mutual to a listed entity in 1998 created an interesting dilemma: how can an exchange participate on the same market that it supervises, and, more pointedly, supervise market transactions that are the source of its revenue? There was no international precedent for an exchange to simultaneously demutualise and list on itself.

THE RESTRUCTURE

Last December the ASX announced that it had completed a review of its supervisory role, structure and processes. As a result of this review, a new subsidiary, headed by Eric Mayne, Chief Supervision Officer (CSO), will be created with the sole responsibility of performing the ASX's supervisory functions. The CSO reports directly to the subsidiary's board, comprising a combination of ASX and non-ASX directors.

The ASX will continue to fund the costs of market supervision and has committed an additional \$10.4 million over the next three years. This includes system upgrades and new technology costing \$4.9 million.

As part of the review, the ASX has also committed to make further improvements which:

- maintain and strengthen market integrity;
- minimise costs of compliance;
- strengthen confidence of listed entities and investors; and
- minimise the perception of conflicts.

A new Regulatory Policy Unit (RPU) will be established to develop ASX policy, respond to government and streamline operating rules. The RPU will be structured as part of the commercial operations of the ASX but it is intended that the RPU consult with the supervisory division on policy matters.

MINIMISING COMPLIANCE COSTS

The push by business to reduce compliance costs in all aspects of regulatory engagement has resulted in

the ASX undertaking five specific initiatives designed to introduce more principles-based rules. They are:

1. A review of discretions under specific rules and the issuance of a new Guidance Note to clarify their operation;
2. Identification and removal of the overlaps between Listing Rules and the Corporations Act;
3. Identification and removal of the overlaps between Market Rules and the Corporations Act;
4. A review, with ASIC, of respective responsibilities with a view to reducing duplication; and
5. A complete rewrite of the Market Rules to identify and clarify the ASX's supervisory role and develop a sound underlying conceptual framework for the regulation of participants.

There is also an existing program to review and streamline the ASX Principles of Good Corporate Governance.

INSIDER TRADING UNIT

The ASX supervisory team will now contain a specialist insider-trading unit with two additional staff members. Last year, there were 83,917 alerts for potentially inappropriate trading incidents, 324 of which were investigated further and, in the past three years, the ASX has referred 68 potential insider trading law breaches to ASIC.

The additional resources, along with systems upgrades, are designed to strengthen the ASX's role as the frontline detector of insider trading activity. Suspicious activity and evidence of potential insider trading practices will continue to be passed on to ASIC which has the responsibility for enforcement.

OTHER ALTERNATIVES

The dilemma faced by the ASX is now a global one. Other exchanges have been dealing with their dual role as a listed market participant and supervisor. The Australian solution is similar to the approach adopted by the New York

Stock Exchange, although other markets, such as the London Stock Exchange and the Deutsche Borse, have handed supervisory responsibilities for new listings to an external regulator.

The *Australian Financial Review*¹ has argued that the job of regulating and supervising the exchange should be placed with ASIC. However, with the ultimate goal being market integrity, Finsia believes that an affiliated but independent, properly resourced ASX supervisory team is the most appropriate mechanism to provide market confidence.

As Tony D'Aloisio, ASX Managing Director and CEO recently commented: "We have an inherent or inbuilt incentive to get the (regulatory) balance right. We need effective supervision to instil confidence in our markets. At the same time, we need to ensure that overregulation does not add to the cost of capital and to transaction costs. Jeopardising either will reduce our attractiveness to customers and damage our business. The standing of Australia's capital markets would also suffer."²

The formation of the Corporate Governance Council which steered the Principles of Good Corporate Governance and Best Practice Recommendations demonstrate the ASX's skills, industry knowledge and culture in producing effective self-regulatory arrangements.

Finsia is a member of the ASX Corporate Governance Council and a newly formed Supervision Participants Liaison Committee. We will continue to monitor market developments in line with our core values, including the protection and promotion of integrity within the financial services industry.

Notes

¹ Editorial, p. 62, 'Market supervision must be independent', 16 Sept 2005.

² Speech to the ASIC Summer School, 'Industry as Self-Regulator: Does it Work', Sydney, 13 Feb 2006. 