

# Compliance in Focus

For Compliance Executives



ASX

AUSTRALIAN SECURITIES EXCHANGE

Spring 2009

## ASX Disciplinary Tribunal and Appeal Tribunal

The ASX Group has statutory obligations to enforce its various Operating Rules. ASX operates two Tribunals to adjudicate disciplinary proceedings ("the Disciplinary Tribunal") and to hear appeals from the Disciplinary Tribunal and certain decisions of ASX Group management ("the Appeals Tribunal"). This article provides an outline on the role, structure, functioning and recent developments of those Tribunals.

### Structure and Membership of the Disciplinary and Appeal Tribunal ('the Tribunal')

Membership of the Tribunal is drawn from a panel of industry professionals nominated by ASX ("the Panel"). The Panel members are selected according to their skills, experience, qualifications and standing and are recommended to the ASXMS Board for selection.

The Tribunal is not a court but a peer review tribunal. The Tribunal functions independently of AXSMS executive management and is supported by legal counsel.

The Tribunal members are permitted and expected to draw upon their experience as market professionals, bringing experience in financial markets and integrity in business in determining cases before them.

The Chairperson and legal counsel will discuss which panel members might be appropriate to hear individual matters. In this regard, the following considerations are relevant:

- the background and experience of the panel member; and
- whether there are any conflict issues that would preclude that panel member from sitting on the Tribunal to hear that matter.

A Tribunal panel of three, including a chairperson, will sit on each matter before the Tribunal.

In FY09, the two Chairpersons of the Disciplinary Tribunal were Mr Philip Chisholm and Mr Peter Marshman. The chairperson of the Appeal Tribunal was Mr Michael Pembroke SC of the NSW Bar. At June 2009, the Tribunal was comprised of 55 panel members.

### About the Disciplinary Tribunal

The role of the Disciplinary Tribunal is to adjudicate disciplinary proceedings in relation to alleged contraventions of the Operating Rules. In line with other Tribunals, it pursues the objective of providing a mechanism of review that is fair, just, economical, informal and quick.

The Disciplinary Tribunal is established under the ASX Disciplinary Processes and Appeals Rulebook ('Rulebook') which came into force from 31 March 2008. The Rulebook sets out the processes and procedures for dealing with contraventions of the Operating Rules in relation to the operation of the licensed markets and facilities across the ASX Group.

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### Jurisdiction

Pursuant to the Rulebook, and on behalf of the ASX Licensees, the Disciplinary Tribunal has jurisdiction in respect of the following Operating Rules:

- ASX Market Rules;
- ASX Listing Rules;
- ACH Clearing Rules;
- ASTC Settlement Rules;
- Operating Rules of the Sydney Futures Exchange;
- Operating Rules of SFE Clearing; and
- Austraclear Regulations.

The powers of the Disciplinary Tribunal in relation to Regulated Persons include the imposition of fines, suspension from all or any of the privileges of being a Regulated Person and requiring educational or compliance programs to be undertaken.

### Procedural Fairness

Under the Rulebook, the Disciplinary Tribunal is not bound by the laws of evidence and is not bound, in determining cases, by its own earlier decisions.

On the other hand, the Disciplinary Tribunal is required to act in accordance with relevant laws and is also bound to observe the rules of procedural fairness. The rules of procedural fairness are a set of rules developed by the courts to ensure that disciplinary and administrative processes are carried out fairly. The two key rules are the "hearing rule" and the "bias rule".

The "hearing rule" requires the Tribunal to ensure that a respondent:

- is given proper notice of the charges against it; and
- is given the opportunity to put its defence of such charges.

The "bias rule" prohibits the Tribunal from acting in circumstances where it is actually biased or where there is a reasonable perception of bias.

A third element of the rules of procedural fairness is often identified. It is the requirement that a tribunal act reasonably on the basis of rationally probative material. This requirement also is reflected in the requirement of the Rulebook that the Tribunal deal with each matter on its own merits.

### Disciplinary Tribunal Outcomes

During the 2008/09 financial year, the Tribunal saw a significant increase in the complexity and seriousness of matters involving allegations of market manipulation, unprofessional conduct and short selling. The Disciplinary Tribunal was required to make findings involving dishonesty, lack of probity and unprofessional conduct. The Disciplinary Tribunal imposed substantial pecuniary penalties.

### Oral Hearings

During the 2008/09 financial year, the Disciplinary Tribunal observed an increase in the number of parties exercising their rights to an oral hearing, as distinct from being heard on the papers alone. Oral hearings comprised of 5 out of 21 (24%) matters heard by the Disciplinary Tribunal.

### Sanctions

It is the Tribunal's view that the most important function of the ASX and the Operating Rules is to maintain the reputation and integrity of the market. In a number of decisions, the Tribunal has commented that in instances where it is found that breaches have caused damage to that integrity, participants should expect that the level of sanction will be commensurate to the seriousness of the breach to reflect the range of penalties now available.

Considerations of sanctions and its effects were highlighted in the Tribunal's consideration of matters in this Reporting Period.

*"The Tribunal considers it both understandable and appropriate that penalties for contraventions which threaten the integrity and efficiency of the market, particularly those involving dishonest, lack of probity or unprofessional conduct, requires a strong message to be sent to other Participants. That message is that contraventions of such rules will be met with substantial penalties, having regard to two overarching and well established factors:*

- (a) *The penalty should constitute a real punishment proportionate to the deliberation, or degree of recklessness, with which the contravention occurred. A "punishment", by definition, involves pain or loss. It will not do so unless it is set at a realistic level. In the case of wilfully dishonest or recklessly careless conduct, the punishment will naturally be greater than in the case of conduct that is merely inadvertent. But in both cases,*

## ASX Disciplinary Tribunal and Appeal Tribunal...cont.

*the penalty should constitute an actual punishment.*

*(b) Second, the penalty should have a deterrent quality. It should be set at a level that is capable of influencing, and is genuinely intended to influence, the conduct of other Participants. It should be such as to realistically deter others who might otherwise engage in similar conduct, whilst recognising that in any individual case, allowance may have to be made for mitigating factors and other circumstances relevant to the particular Participant."*

### About the Appeal Tribunal

The Appeal Tribunal is also established under the Rulebook. The Rulebook sets out the processes and procedures for dealing with Appeals in relation to the operation of the licensed markets and facilities across the ASX Group.

The Appeal Tribunal may hear and determine both disciplinary and non-disciplinary matters. There is a right of appeal to the Appeal Tribunal against determinations of the Disciplinary Tribunal. There is also a right of appeal where a Participant is dissatisfied with a decision of ASX in relation to a number of ASX Operating Rules.

The Appeal Tribunal cannot simply substitute its own decision. The power of the Appeal Tribunal is limited to reviewing any findings reached in the decision under appeal by reference to the evidence and the law at the time of the original hearing. In reviewing the findings reached in the decision under appeal, the Appeal Tribunal must decide whether the findings were right or wrong. If it concludes that there was some legal, factual or discretionary error by the Disciplinary Tribunal, the Appeal Tribunal may vary or set aside the decision appealed from. But before doing so, an error must be revealed which results in the decision not being correct on the evidence as it was presented or in accordance with the law as it then stood.

### Administration of the Tribunal

Administration of the Tribunal consists of a legal counsel, a junior lawyer and a para-legal. The Tribunal may also request the appointment of external counsel to assist it in certain matters.

### Professional Development

The legal counsel to the Tribunal continues to educate and support Panel members in order to enhance the Panel members' understanding of the changes incorporated in the Rulebook and of their obligations and responsibilities as members of the Panel. The legal counsel also provides guidance to the Tribunal on the process of arriving at a decision, as to what facts are to be accepted, what facts are to be rejected and where there are conflicting facts.

The Tribunal is currently seeking registration and membership with the Council of Australasian Tribunals (COAT), a national network of Tribunals that support the development of best practice models and model procedural rules, standards of behaviour and conduct for members. It is anticipated that membership will assist in the provision of training and support for ASX Tribunal members.

### Announcements

The Rulebook provides that where a Participant has had a sanction imposed upon them, the Tribunal will, unless it determines otherwise, make a public announcement of the name of the Participant concerned and any other information that is considered relevant. The Disciplinary Tribunal, and where relevant the Appeal Tribunal, may decide in what form and in what manner the announcement should be made.

A key message coming out of the decisions of the Tribunals in FY09 relevant to all participants was the importance of transparency and clarity of messages released in announcements and public disciplinary circulars, bulletins and notices. The Tribunal's issuing of announcements in respect of disciplinary matters is integral to, and plays a pivotal role in, educating market participants and providing guidance on the standard expected of those participants. During FY09 the Tribunal changed its approach in respect of announcements. The announcements were more detailed and often lengthier.

## ASX Compliance Hot Topics

### Professional Indemnity Insurance requirements

With the introduction of ASX Compliance Monitor ("ACM") we wish to remind Participants that pursuant to ASX Market Rule 4.6.4 and ACH Clearing Rule 4.3.1 (as applicable) a Participant is required to immediately notify ASX and ACH (as applicable) of any notification to its insurer of any claim, potential claim or circumstance that might give rise to a claim against them. Participants are also required to provide notification if the claim, potential claim or circumstances proceed to litigation.

The mechanism which should be used to facilitate such a notification obligation is ACM. Participants should be aware this notification obligation does not obviate them from including a monthly report on their contingent liabilities as required for compliance with their ACH capital liquidity returns.

The ACM system has a notification form specific to this obligation which outlines key areas the Participant is required to address in their submission to ASX / ACH including:

- Immediate notification to ASX/ACH of any notification by a Participant to an Insurer of any claim, potential claim or circumstance that might give rise to a claim;
- The ASX notification must include the following details:
  - any circumstance which is likely to give rise to a claim or potential claim against the Participant;
  - the receipt of a notice from any person of any intention to make a claim or potential claim against the Participant; and
  - the details of any claim, potential claim or circumstance against the Participant including:
    - the gross contingent liability;
    - the net contingent liability;
    - the full name of the Participant's insurer; and
    - the date the Participant notified its insurer of the claim, potential claim or circumstance.

In addition, the Participant will be requested to provide a sufficiently detailed summary of the circumstances of the claim (or potential claim) together with a copy of the notification to the Participant's PI Insurer.

### Private Arrangements between Advisers and their Clients

ASX has recently become aware of situations involving a number of Participants where advisers had entered into private arrangements with their clients without disclosing these

arrangements to the Participant.

Examples of such arrangements are cash loans to (from) clients and advisers lending (borrowing) securities to (from) clients for lodgement as collateral for margin loans.

Participants should consider whether they have educated their representatives with respect to the types of personal arrangements that are required to be disclosed to the Participant, conflicts of interest arising from personal arrangements, why they should be disclosed and the potential consequences of non-disclosure.

Transparency by representatives will place Participants in a position to assess the potential risks to the Participant and any possible impact the arrangements could have on their regulatory obligations. This in turn, will allow Participants to put in place whatever controls each Participant deems appropriate, in order to monitor and manage those potential risks.

### Errors, suspense accounts and trade re-bookings

Error and rebooking management is emerging as a key focus for ASX at present. The following reflects some of the issues ASX is giving consideration to.

#### Case Study 1

A broker works in a regional office for a brokerage firm ("the company"). The broker operates a number of discretionary trading accounts on behalf of clients (i.e. that the client has given the adviser a degree of discretion in relation to securities to be bought and sold by the client). However, the discretion is not documented as Managed Discretionary Accounts.

The adviser buys 10,000 units of ordinary security XYZ Limited with a normal T + 3 settlement on Monday for a discretionary trading client, ("first account"). By lunch time Wednesday, the price has risen. The broker instructs his regional bookings team to reverse the trades from the first account and rebook to a completely unrelated account, which happens to belong to a company of which the advisers' mother-in-law is the sole director and beneficial shareholder ("second account"). The stock is then sold for the second account.

On complaint from the affected client, the compliance manager reviewed the brokers' activity over the past two years and found that several profitable trades had been rebooked from a number of accounts across to the second account the day after trades were executed.

## ASX Compliance hot topics...cont.

### Case Study 2

An adviser working for a brokerage firm ("the company") manages a number of trading accounts for clients, with an agreement to trade on a discretionary basis, securities for mid to large cap resource companies. However, the discretion is not documented as Managed Discretionary Accounts. One client ('affected client') who has signed on to this advisers' strategy complained about a number of transactions he saw on his monthly statement:

- On Monday four weeks ago, the adviser purchased 100,000 YUU Banking Corporation Limited ("YUU Ltd") for the affected client. By Thursday YUU Ltd had announced an unexpected loss and the stock plummeted 65%. The adviser sold 50,000 units of YUU Ltd on the client's account. By Friday the stock fell another 40%. The adviser sold the other 50,000 units.
- On Tuesday three weeks ago, trying to make back the losses, the adviser bought 60,000 CORP Resources Limited deferred Instalment Warrants on market. On Friday two weeks ago, these were due for settlement. The trade failed as the client did not have sufficient funds in their account. The client offered the explanation that he had never authorised the adviser to trade derivatives for his account.

### Case Study 3

An adviser working for a national brokerage firm ("the company") was the subject of a client complaint one week ago regarding a number of booking reversals on her monthly statement with the reference "A/C Incorrect". A compliance review of the adviser's activities discovered a number of potential issues which would require further investigation:

- Last Thursday the adviser traded 100,000 units of YXY Limited over the day, and booked these trades into his errors account. That afternoon these trades were booked into numerous client accounts, the company's house trading accounts and a staff trading account.
- The adviser made several re-bookings across many different accounts over many days last month, with the re-booking reason "A/C Incorrect". Many re-bookings resulted in changes to beneficial ownership.
- Analysing the adviser's trading history over a five year period, the compliance review found that although the

trade consideration went down, the number of error trades spiked, especially when comparing consideration vs. errors between three years ago and two years ago.

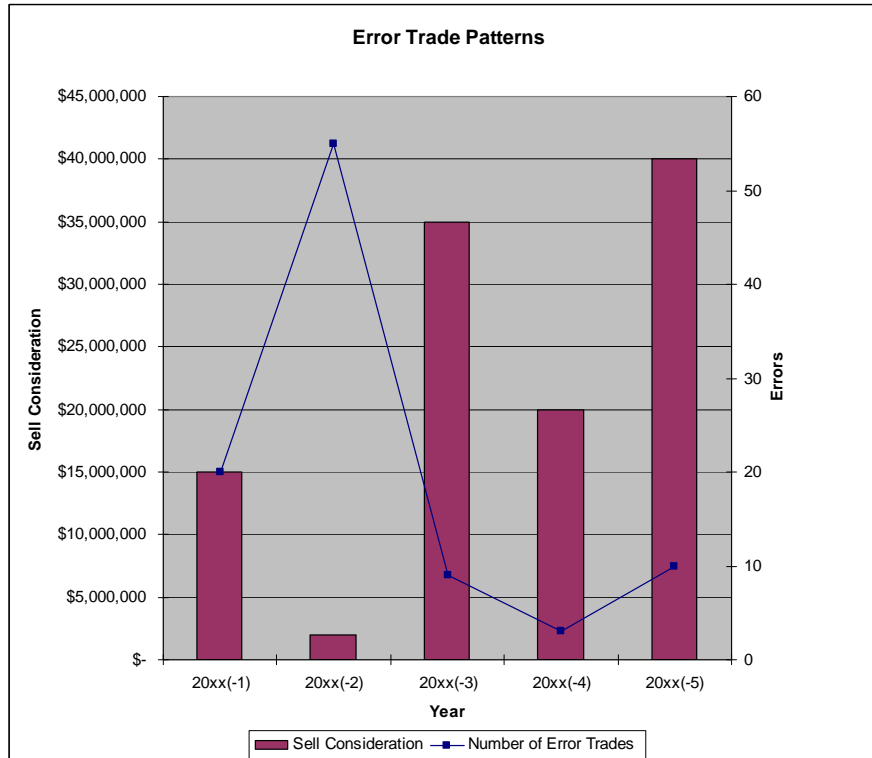
### Case studies – analysis

The first two case studies illustrate situations where Participants did not have operations and processes in place that were designed, implemented and functioning so as to prevent and detect inappropriate booking practices and unauthorised discretionary trading – Case Study 1 and Case Study 2 respectively.

With regard to Case Study 3, although there may not be any mischief in these trades, these should be looked at as potential indicators of risk, and questions should be asked whether there were appropriate controls at all levels of the process:

- Are there appropriate staff trading clearance controls? Were there controls in place to prevent front running of staff orders over client orders., Were there controls in place to prevent the aggregating of personal trades with client trades;
- Is there an investigation as to why transactions were continually being booked into incorrect accounts? Are there appropriate booking controls in place to ensure that bookings that result in changes to beneficial ownership are scrutinised?
- The graph on the following page is a hypothetical example of volume and value of trades over the past five years for this adviser's account.

## Compliance Hot Topics...cont.



Over the period of 20xx(-2) and 20xx(-1) there was a considerable spike in consideration vs. errors – consideration was down, yet errors were up. Participants should look at these types of activities as an indicator to make further enquiries into trading patterns of an adviser.

### Considerations for an effective errors and re-bookings policy

[ASX Market Rules Guidance Note No. 6](#) states that “ASX expects all Market Participants to adopt and implement management structures and supervisory procedures that are specifically tailored to the type and scale of the Market Participant’s business”.

Looking at the case studies presented, as a compliance practitioner for a Participant, you might say to yourself “we have the correct supervisory procedures that match our business, and on this basis incidents such as the above would not occur”. But with regard to suspense accounts and re-bookings, do you consider that you have the appropriate controls in place to mitigate the following risks from occurring?<sup>1</sup>

- Unauthorised discretionary trading;
- Hiding trading activity and therefore profit /loss;
- Unauthorised principal trading;
- Allocation of favourable positions to related accounts / soft dollar kick backs or worse (i.e. fraudulent cash/script journal entries);
- Settlement risks if error position not managed correctly;
- Potential liquidity problems / substantial shareholding problems depending on the size of error;
- Hiding inappropriate representative conduct / lack of technical competency;
- Hiding / facilitating market manipulation / insider trading/front running client orders.

### Question a participant might ask of their errors and re-bookings policy

<sup>1</sup> Note - this should not be interpreted as being a comprehensive list of risks that may arise from the re-booking of trades and errors. The inherent risks in any business model can sometimes be unique to the particular type and scale of a Market Participant.

Whilst errors, suspense accounts and trade re-bookings can occur on a daily basis, the existence of some controls can mitigate improper use of these accounts and inappropriate

## Compliance Hot Topics...cont.

booking practices.

Participants need to ensure that these functions and controls are being reviewed appropriately. An indicator like the one in case study 3 – a fall in consideration vs. a spike in error trades – should not be the only circumstances that should prompt queries into a pattern of behaviour.

Controls should be able to demonstrate how the error / re-booking / journal processes operate. This is not only related to pre-authorisation but also could include some sort of post-transaction analysis, monitoring and supervision to identify any potential mischief / inappropriate conduct. Participants should be able to answer the following questions:

- How do you ensure all trades executed are linked to specific orders / clients prior to end-of-day close off?
  - Do you ensure suspense accounts have a 'zero' balance at end of day, or at least are reconciled at the end of each day?
  - How do you supervise the use of any suspense accounts for compliance with the ASX Operating Rules and the Act?
  - How are errors handled, monitored, controlled and supervised to detect any inappropriate conduct?
  - How are re-bookings patterns monitored and detected between related / unrelated accounts?
  - What post transaction review 'testing' is completed having regard to error handling, bookings, rebookings and positive end-of-day balances in any suspense account? Specifically, what reviews are conducted to validate any error independently of the person reporting the error?
  - How are the tasks and functions performed by the Bookings Clerks supervised? Are there exceptions reports around these processes?
  - Is there segregated system access for anyone performing bookings versus the ability to enter in transactions? Are there routine system access rights checks performed? Are the booking rights appropriate to the person's experience?
  - What security controls exist in relation to the dispatch of confirmations, including controls around postal address changes?
  - What is the threshold of errors where management must be involved prior to reversal of an error?
  - Is the finance department involved or notified of errors during the day which could cause impacts to a Participant's capital position? What is the control process supporting this to ensure it occurs?
- Is an errors form used for all errors and re-bookings?
  - What information is captured and monitored so as to detect errors constantly being made by the same person or in the same security or at the same time of the day etc?
  - Are errors recorded specifically as errors to record periodic patterns? Are activity reviews performed to isolate any one account which has had large numbers of rebookings to or from the account?
  - What control processes are implemented to support errors in exchange traded options?
  - Are profits able to be paid out from errors accounts? If so what reviews are conducted to ensure the adviser is not trading on the account inappropriately?
  - Can the same representative enter an order to trade out of their error or is the facilitation of error rollouts centrally controlled?
  - Does the firm provide periodic (eg. monthly) reporting to the Responsible Executives and / or the Audit, Risk or Compliance Committee regarding the patterns of errors?
  - Are all errors reported, regardless of whether there is no profit and loss impact, or whether or not they are below a certain threshold value?
  - Is there sufficient information captured to detect errors constantly being made by the same person, or in the same security, or at the same time of day etc? Review of this information could identify the need for additional training etc.
  - Are there any reviews completed between staff trading and the error accounts of an adviser?
  - Even if the suspense account ends up square after a days trading, are the trades booked into and out of the suspense accounts being looked at?

### Conclusion

The size of the errors, the number of re-bookings that are done, or the size of the consideration going into and out of suspense accounts are important considerations. Participants should be aware of the importance of having the necessary monitoring and supervision controls in place to prevent persistent recurrences and to identify any potential mischief or inappropriate conduct.

## Compliance Hot Topics...cont

### Complaints handling procedures

The following is a list of things to consider when reviewing your Participant's Complaint and Escalation Procedures:

#### Standards

- Do your policies and procedures comply with the Australian Standard – AS ISO 10002-2006?

#### Management reporting

- From a supervisory perspective how are complaints escalated and reported on?
- Are complaints received reviewed at committee level?
- Is the length of time for the review and rectification reviewed at committee level?
- What information is provided to the Board on complaints and their resolution?

#### Staff awareness and training

- How are staff made aware of the procedures and their obligations in relation to the procedures?
- How are the procedures made available to staff?
- What training is provided to staff in respect of their obligations in relation to compliance with the procedures?
- Do you keep records of staff training?
- Are there any consequences or sanctions if staff do not attend/complete any training on compliance with the

procedures?

- Do you provide refresher training/continuing education to staff in respect of complaints handling?

#### Escalation and reporting

- What are the sanctions or consequences for non-compliance by staff members with the procedures?
- How are matters escalated?

#### Review and identification of issues

- How does your firm scope out a satisfactory investigation into a complaint?
- How are systemic issues identified?

#### Referrals to supervisory bodies

- Who within the Participant determines whether a complaint is 'significant' and should be reported to ASX, ASIC, any other regulatory body or Professional Indemnity insurers?
- What criteria are used to determine significance?
- What records of the assessment for significance are maintained?

Note: Participants need to ensure their complaints handling procedures at all times comply with their obligations under the Corporations Law and that they have had regard to ASIC's Regulatory Guides on this area.

## Investigations

### Participant Obligations – Reporting of Derivatives Market Transactions

Trading Participants should consider the following reporting obligations when entering into Derivatives Market Transactions to ensure that they are reported to ASX promptly and in the correct form and manner.

ASX Market Rule 21.5.1 provides that, subject to ASX Market Rule 21.5.2, Trading Participants must promptly report each Derivatives Market Transaction entered into by the Trading Participant by lodging details of the transaction with ASX in the form and manner set out in the Procedures.

ASX Market Rule 21.5.2 provides that a Trading Participant is taken to have lodged the required information if that information is generated automatically and supplied to ASX through facilities provided by ASX in accordance with the Procedures.

#### Derivatives Market Transactions

Derivatives Market Transactions are transactions in Futures, Options and any other contracts that ASX authorises for trading on a Trading Platform and determines to be a Derivatives Market Contract. For the purposes of ASX Market Rule 21.5.1 a Derivatives Market Transaction includes those transactions entered into as components of a Combination.

## Investigations...cont.

### Timing of Reporting Derivatives Market Transactions

ASX notes that the term “promptly” whilst it is not defined in the ASX Market Rules would likely be interpreted in all the circumstances of the particular transaction. That is, the Derivatives Market Transaction must be reported within a time that is reasonable in the circumstances. This is a time that in most circumstances ASX expects to be measured in minutes rather than hours.

A Trading Participant may fail to achieve compliance with ASX Market Rule 21.5.1 where the delay in reporting a Derivatives Market Transaction is a result of the Trading Participant considering, arranging, undertaking or completing a hedge for the relevant Derivatives Market Transaction.

### Form and Manner of Reporting Derivatives Market Transactions

The form and manner in which Trading Participants must report Derivatives Market Transactions are set out in ASX Market Rule Procedure 21.5.1.

The form of reporting must include all of the following:

- Date of the transaction;
- Identity of the Trading Participants to the transaction;
- The underlying asset (e.g. the Underlying Financial Product or Underlying Index);
- Exercise Price or the Exercise Level (for an Option);
- Maturity or Expiry Date;
- Number of Derivatives Market Contracts the subject of the Derivatives Market Transaction; and
- Premium or Price, expressed in the same manner as that in which bids or offers are required to be made, being:
  - in the case of an Option over Underlying Financial Products, the amount of money per unit of the Underlying Financial Products;
  - in the case of an Option over an Underlying Index, the number of points of the Index; and
  - in the case of the Cash Market Product component of a Derivatives/Cash Combination, the amount of money per unit of the Underlying Financial Products;
    - Condition Code, if any; and
    - Any other information required by ASX to be lodged with ASX.

Details relating to the relevant Condition Code, if any is applicable, are outlined in ASX Market Rule Procedure 21.5.1.

In accordance with ASX Market Rule 21.5.2 and set out in ASX Market Rules Procedure 21.5.2 (21.5.1) a report is generated by the Trading Platform for the following transactions and a Trading Participant need take no further action to report them:

- Orders matched in the Central Orderbook;
- Orders transacted on the Bulletin Board; and
- Any transactions arising from the offering of 50% of orders crossed under ASX Market Rule 22.

A Trading Participant is required to lodge the information required by ASX Market Rule 21.5.1 using the Report Trade function of the Trading Platform in respect of the following Derivatives Market Transactions (all times are Sydney times):

- The crossed quantity of orders crossed under ASX Market Rule 22.
- Dealings on behalf of overseas clients under ASX Market Rule 21.7. Overseas trades must be reported on the next Trading Day between 7:00am and 9:45am.
- Special Crossings under ASX Market Rule 22.3. Special Crossings in Futures Market Contracts over an Underlying Commodity which is grain and Special Crossings in Options Market Contracts over Futures Market Contracts over an Underlying Commodity which is grain must be reported on the Trading Day on which they are transacted between 8:00am and 7:00pm. Special Crossings in Options over an Underlying Index or Futures over an Underlying Index must be reported on the Trading Day on which they are transacted between 7:00am and 7:00pm. Special Crossings in all other Options and Futures must be reported on the Trading Day on which they are transacted between 9:00am and 6:00pm.
- Late trades in stock Options under ASX Market Rule 21.6 must be reported on the Trading Day on which they are transacted between 4:20pm and 5:00pm. Late trades in Futures Market Contracts over an Underlying Commodity which is wool must be reported on the Trading Day on which they are transacted between 4:30pm and 5:00pm.

ASX encourages continued compliance with ASX Market Rules 21.5.1 and the related Procedures by ensuring that Derivatives Market Transactions are reported to ASX promptly and in the correct form and manner outlined in ASX Market Rules Procedure 21.5.1.

## Capital Monitoring

### Spot Checks

ASX Capital Monitoring has implemented a procedure for participant spot checks, as part of its ongoing monitoring of participants' compliance with the Risk Based Capital Requirements.

As part of the procedure, Capital Monitoring will, from time to time, undertake the following forms of spot checks:

- Industry-wide spot checks – targeting a specific aspect of ASX Rule S1A/ACH Rule S1 and seeking to verify that all participants comply with the requirements relating to that specific item; and
- Participant-specific spot checks – looking at a participant's compliance with the ASX Rule S1A/ACH Rule S1 capital requirements. This could either be targeted to one particular aspect of its calculations or could be more general (for instance, looking at calculations in their entirety and/or reviewing the procedures manual).

ASX Capital Monitoring acknowledges that the undertaking of such spot checks may place additional pressure on Participant's resources, and we appreciate your continued support and cooperation.

### Reminders for Participants that are subject to the Risk Based Capital Requirements

#### Capital Liquidity Returns

It has come to our attention that there are still a number of common errors being made by Participants when completing their capital liquidity returns. To prevent further errors, it would be appreciated if Participants could take note of the issues below and keep them in mind when completing future returns:

- Please note that liabilities and assets should not be entered into the balance sheet as negative numbers and similarly, revenue and expenses should not be entered into the income statement as negative numbers.
- Excluded assets should also not be entered into the return as negative numbers. It is not possible to have a negative excluded asset. This would result in Liquid Capital being overstated.
- Please ensure that personnel details are entered into Section 17.1 (Personnel/Professional Indemnity Insurance) for each return.

- The questions in Section 12.4 (Contingent Liabilities) need to be answered for each return and if 'yes' is selected for any of the questions then please ensure that details are entered into the relevant sub-sections.
- Participants are again reminded that if amounts are entered into the '100% of Contract value/100% of Market value' row in Section 2.1 (Non-Margined Financial Instruments method) then amounts must not be entered into any of the other >10 **business day** rows.

#### General

- We would like to remind Participants that the capital requirements apply to the Participant legal entity only and not on a consolidated group basis. Participants should therefore ensure that all calculations and returns are based on the accounts and exposures of the Participant entity only.
- We have noticed that a number of Participants are still completing the 'Auditors Report on Financial Information' incorrectly by choosing the wrong entity references (ie, ASX or ACH). It would be appreciated if Participants and auditors could read the instructions on how to complete this report correctly. If a Participant lodges an incorrect auditors report, a revised auditors report will need to be lodged.
- Participants should ensure that their ASX Rule S1A/ACH Rule S1 procedure manual is reviewed and updated regularly to reflect changes in business activities or rule changes. ACH Participants should ensure that they have updated their manual to reflect the \$2m Core Liquid Capital minimum requirement.
- Please also be reminded that **approved** subordinated debt (**ASD**) agreements in place with ASX/ACH do not constitute ASD under the SFE or SFECC Rules and hence should not be included as ASD in the NTA returns lodged with Futures Supervision.
- Participants should be aware that if an automated response is not received after sending an email to the [asx.returns@asx.com.au](mailto:asx.returns@asx.com.au) or [ach.returns@asx.com.au](mailto:ach.returns@asx.com.au) mailbox then Capital Monitoring has not received your email.

## ASX Futures Supervision

### SFE Annual Returns

A reminder to SFE Participants with a 30 September 2009 financial year end that the SFE Annual Return is due to be lodged with SFE by no later than 31 December 2009.

SFE Participants are reminded that as part of the SFE Annual Return submission, a copy of the Annual Audited Accounts and the Annual Audit Certificate along with the accompanying Directors' Declaration are required to be submitted to SFE. These proforma documents can be obtained by contacting Ben Christiansen on (02) 9227-0222 email [ben.christiansen@asx.com.au](mailto:ben.christiansen@asx.com.au).

### Commonwealth Government Bond Futures Contracts – Market Information Update

As market users will be aware, the September 2009 3 Year and 10 Year Treasury Bond Futures contracts expired on Tuesday, 15 September 2009 at 12:00 noon. SFE wishes to:

- Inform traders of initiatives to enhance the process of polling quotes provided by firms listed on the Bond Settlement List over the morning of the Last Trading Day. These quotes are used for the purposes of establishing the bond futures settlement prices;
- Advise traders and risk managers to review their risk appetite in the period leading up to each expiry; and
- Remind traders of the expiry position limits that came into effect at the close of trading on Monday 14th September.

### Enhancements to the Market Polling Process

SFE is exploring initiatives to enhance its market polling process. One of the initiatives proposed is to source the expiry day bond data via a Request for Quote through the Yieldbroker Platform. The objectives of any change to the existing manual process would be attempting to enhance ASX's ability to obtain more accurate, timely and concurrent quotes for the basket stocks in each contract. ASX Operations will be working with firms listed on the Bond Settlement List to ensure that any change to the polling system is fully endorsed by the Bond market participants and is robustly tested prior to any implementation. As per existing arrangements, in the very unlikely event of SFE failing to obtain sufficient data through this new electronic polling process or directly from the firms listed on the Bond Settlement List, SFE will look to its Emergency Power rules in order to determine each con-

tract's settlement price. In the unlikely event of use of these rules, SFE may consider a variety of factors and data sources including, but not limited to:

- data from alternate sources indicating Treasury Bond trading that occurred during the expiry window;
- the prevailing or latest Exchange for Physical levels for the Treasury Bond basket stocks; and
- data from other relevant physical or derivative markets.

### Assessing Risk Appetite

As part of its Market Operator licence which imposes front-line market supervisory authority and obligations to ensure that its markets are fair, orderly and transparent, SFE supervision personnel monitor trading activity and holdings both throughout the life of the contract and approaching expiry, and initiate contact with relevant parties to gain adequate assurance as to traders' intentions and understanding of their obligation to trade in a manner consistent with the fair, orderly and transparent operation of SFE's markets.

SFE wishes to remind traders and risk managers that they review their risk appetite before making trading decisions as an expiry approaches, especially with regard to the timing of position rolls and the potential effects that the timing of their trading may have on their ability to execute this business at a desirable price. Traders and risk managers who are averse or unwilling to accept this price risk may look to close or roll their positions well in advance of the day of expiry.

### Expiry Position Concentration Limits

SFE wishes to remind all traders that position limits in both bond contracts (currently 25,000 for the 3 Year Treasury Bond Contract and 19,000 for the 10 Year Treasury Bond Contract) come into effect at the close of trading on the day before expiry, and remain in effect until the contracts expire. These limits apply at a corporate group level to all traders regardless of whether a single Participant or multiple Participants are used to clear contracts, or whether some holdings are carried through intermediate entities.

Should you have any queries in relation to the above, please contact Nick Gaut, Senior Market Analyst, Futures Supervision, on (02) 9227-0226 or at [nick.gaut@asx.com.au](mailto:nick.gaut@asx.com.au)

## ASX Futures Supervision...cont.

### SFE Recent Rule Amendments - New ASX Link

Participants are advised that the "ASX Recent Rule Amendment" link has been updated to include SFE Operating Rules and SFE Clearing Corporation Rules.

[http://www.asx.com.au/supervision/rules\\_guidance/recent\\_rule\\_amendments.htm](http://www.asx.com.au/supervision/rules_guidance/recent_rule_amendments.htm)

The above link will record the date that the rule changes were made to the SFE Operating Rules and SFE Clearing Corporations Rules and provide a link to the related notice.

The present notification process will continue, where Participants are informed of Rule Changes via the ASX Online Email Notification Services and new notices published on ASX Online.

The new link will address the difficulty Participants have previously experienced with Rule Changes i.e. tracking through large volumes of notices to find the relevant notice in relation to the SFE Rule Change.

*Please Note:* only amendments to the SFE Operating Rules and Section 1-5 of the Procedures Determinations and Practice Notes are included here. For amendments to contract specifications, you will need to continue to refer to the [SFE Notices](#).

### Half-Tick Functionality on Intraday and Overnight Options

The Exchange wishes to remind all Participants that orders in the Intraday and Overnight Options over the Exchange's Interest Rate Futures Contracts are available to be traded in half-ticks.

Futures Supervision staff would like to remind all Participants that, provided there is a genuine intention to trade at that level, orders can legitimately be placed in the Intraday and Overnight Options contracts at half-tick values, including during the pre-open of each trading session.

Should you have any queries please contact Robert Coaldrake, General Manager Futures and Capital Monitoring on (02) 9227 0223 or [Robert.Coaldrake@asx.com.au](mailto:Robert.Coaldrake@asx.com.au) or Janice Coles, Senior Futures Supervision Officer on (02) 9227 0224 or [Janice.Coles@asx.com.au](mailto:Janice.Coles@asx.com.au).

### Compliance Recommendations

#### Open Interest and Back-to-Back Positions

Participants are reminded that Open Interest figures reported by the Exchange are a summation of the number of contracts that Participants maintain in their House and Client Clearing Accounts. These numbers may fall precipitously where Participants close out contracts that are maintained back-to-back (i.e. a short and long position maintained for the same account at the same time).

The Exchange recognises that in deliverable contracts where the underlying product is differentiated (e.g. Greasy Wool), there are circumstances in which a trader may wish to both make and take delivery of a commodity and therefore maintain back-to-back positions. In other circumstances, the Exchange recommends that Participants act in accordance with best practice and close out all back-to-back holdings on a daily basis.

A guide to this best practice can be found in the Practice Note attached to Clearing Rule 46.5.

Because of the way in which these holdings are subject to Participants' management of their Clearing Accounts, it is recommended that Participants not base trading decisions or risk management triggers solely on proportions of Open Interest that are carried at any time.

#### Thumbs Down – Client Orders

During a recent investigation into a Participant's trading activities, Futures Supervision staff noted that order instructions given to the Participant by Clients via Bloomberg were incomplete; however the Participant's Representatives accepted them as orders and subsequently executed trades based on those incomplete instructions.

In one instance this related to the direction of the order, and in another instance, to the price of the contract.

Futures Supervision strongly reminds Participants to ensure that their Representatives have clear instructions representing all necessary components of an order (i.e. price, volume, direction) from their Client, prior to entering those instructions into the Trading Platform for execution. This applies regardless of the method of order placement, for example Bloomberg, email or telephone.

## Articles of interest

### London Stock Exchange/Financial Services Authority

[Order Book Conduct: Layering / Spoofing](#) – Compliance Update (LSE)

[Manipulation of the order book – layering or ‘spoofing’](#) – FSA Market Watch, August 2009

### FINRA

[Fines for failure to establish adequate systems and procedures to supervise outsourced services](#) – FINRA News Release 22 September 2009

### AUSTRAC

See AUSTRAC’s new [typologies and case studies reports](#), which outlines some of the latest money laundering methods and other financial crimes in Australia.

AUSTRAC has accepted its first [enforceable undertakings](#) in relation to non-compliance with anti-money laundering and counter-terrorism financing laws. The undertakings are from Barclays Bank and Mega International Commercial Bank.

### APRA

[Guidance – OTC derivative market](#) - APRA, ASIC and the Reserve Bank of Australia have jointly released a report enti-

itled [Survey of the OTC Derivatives Market in Australia](#), which identifies a number of areas in which operational and risk management practices could be enhanced.

### ComLaw

[Anti-Money Laundering and Counter-Terrorism Financing Rules Amendment Instrument 2009](#)

### ASIC

ASIC has released a [consultation paper](#) as a precursor to publishing guidance on the substantial holding disclosure obligations arising from securities lending and prime broking transactions.

ASIC is [seeking comment on credit rating use in disclosure documents](#). The consultation paper seeks the views of stakeholders, including organisations representing retail investors. Submissions on the issues in the Consultation Paper close on Thursday 22 October 2009.

### ASX

ASX has released its report on compliance with the [ASX Corporate Governance Council’s Principles and Recommendations](#).

## Education & upcoming events

### Australasian Compliance Institute (ACI)

#### Networking Series

24 November 2009 – Perth  
25 November 2009 – Sydney  
3 December 2009 – Melbourne

### Stockbrokers Association of Australia (formerly SDIA)

#### Responsible Executive Refresher Workshop

17 November 2009 – Sydney

For other education and training opportunities, see the [SAA website](#).

### AFMA

#### Third Annual AML/CTF Conference

16 & 17 November 2009 – Sydney

#### Risk in Focus: Market Risk

18 November 2009 – Sydney

#### Responsible Managers: Your Role and Obligations (Clinics 1 and 2)

19 November 2009 – Sydney

### Ongoing ASX education initiatives

For details, including dates, go to [www.asx.com.au/classes](http://www.asx.com.au/classes).  
For Accredited Derivatives Adviser exams go to [www.asx.com.au/adaprogram](http://www.asx.com.au/adaprogram).

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