

BENCHMARKING STOCK EXCHANGE PRACTICES

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1. Introduction

Good afternoon everyone. Or should I say "Guten Tag". It is indeed a pleasure to be here.

Congratulations too to Deutsche Börse and Dr Muller for organising this, the third Chief Regulatory Officers' conference with the very appropriate theme of self-regulation vs legislation. I am especially pleased with the opportunity to present on the topic of benchmarking of regulatory services as they relate to stock markets, not only because it is particularly pertinent to this conference's theme but because it is so relevant to what we do on a day-to-day basis.

Presentation

- **Introduction**
- **Why benchmark?**
- **What could we benchmark?**
- **How do we move forward?**
- **Discussion**

For this discussion, I would like to provide my thoughts on why we should benchmark, what we could benchmark and how we might go about doing this. I have planned to speak for 20 minutes and have reserved another 20 minutes to hear your views.

2. Why Benchmark?

Why benchmark?

- **Government regulator or supervisory authority**
- **Shareholders**
- **Market integrity matters**
- **Performance measurement tool**

The idea of benchmarking the regulation of exchanges is not new. Most of you would be aware that the World Federation of Exchanges undertook a benchmarking exercise in 2004. An interesting insight from the Report released in 2005 is that at that time the majority of exchanges said that regulation was a significant part of their brand or commercial strategy. I think I can safely assume that that position has not changed. We all know that market integrity matters to the health of our respective markets and that we would wish to retain the regulation of the core aspects of our markets.

The very theme of this conference suggests that the position that exchanges have traditionally held in the regulation of markets is not unassailable. At the risk of labouring what has already been well-covered in the two days, I would like to elaborate on where I believe the pressure points are:

First, while it is likely that most exchanges have good working relationships with their respective government regulator or supervisory authority, there is nevertheless the continuing obligation or responsibility for exchanges to demonstrate that appropriate standards of supervision have been met. In particular, whether exchanges have sufficient resources (human, financial and technological) to ensure a fair, orderly and transparent market, or fair and effective clearing or settlement facility. I would hazard a guess that most of us demonstrate this by comparing with how we have done in the past. However, changes in regulation, evolving buy and sell side business models and importantly, the power of technology suggests that the markets we are dealing with now cannot be the same as markets five years ago. Without appropriate measures to benchmark performance against, a challenge for SROs would be to demonstrate that our actions are not coloured by conflicting interests.

Secondly, exchanges operating as listed entities have the added responsibility of demonstrating to shareholders and analysts that their regulatory function is operating efficiently and effectively. Again, I believe SROs are in a double bind. The main point is that if we are efficient as measured by costs and staff numbers, we could also be charged by government regulators or the media with "cutting down on regulation".

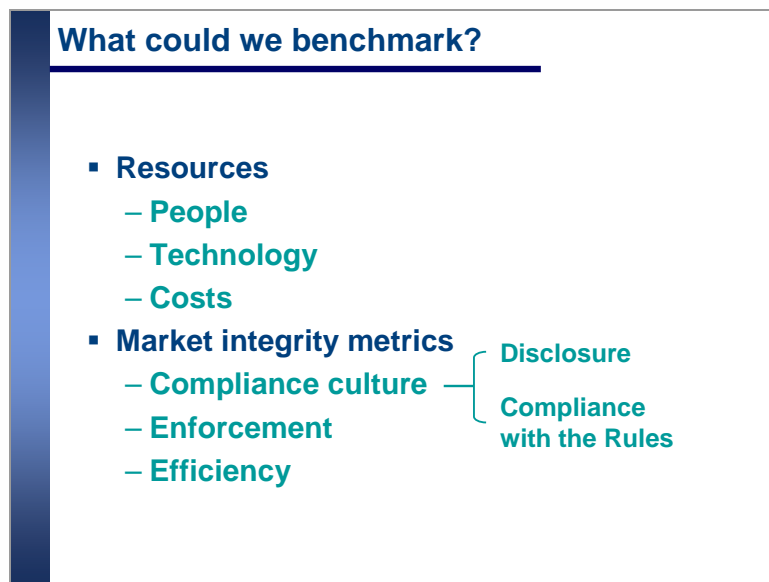
Both of these points lead to an observation that was made earlier. Market integrity matters to exchanges. With or without pressure from external stakeholders, I and I'm sure many others here, would like to know how the markets we regulate measure up.

Lastly, the unique nature of what we do means that many traditional measures of performance such as profitability and market share do not apply. Certainly, many management and efficiency type measures translate well into the management of an SRO. Many of us would have timeliness standards (eg time taken to complete an investigation) and efficiency measures (eg the number of matters handled per compliance adviser). But in an increasingly outcomes-focused environment, there do not appear to be many market integrity-related outcomes that we can tie our performance as a whole to, as well as the performance of our supervision staff.

To summarise, I think there are at least four reasons for SRO's to embrace benchmarking:

- (i) It would assist in measuring our regulatory performance and the performance of our staff.
- (ii) It would assist in measuring the integrity of our respective markets.
- (iii) It would assist in demonstrating to our regulators that we are meeting our key licence obligations (eg having sufficient resources).
- (iv) It would assist in addressing the perception of conflicts and suggestions that we are cutting costs related to regulation.

3. What could we benchmark?



Having put forward a case for why I believe benchmarking would be useful, I'll have to declare up-front that the whole subject gets challenging from this point!

With that caveat, what is included here serves to act as “thought-starters” for the discussion to follow.

Broadly, we could either benchmark, in layman’s terms, the “inputs” into our activities or the “outputs”, or both.

Resources

By inputs, we could take it to narrowly mean the number of people we have performing supervisory functions and the corresponding costs. On the face of it, this is straightforward and certainly there appears to be a degree of objectivity with it, especially if we are just considering front-line supervisory functions. For example, we could benchmark:

- the number of listed entities supervised per adviser
- the average number of IPOs handled per adviser at any one time
- the average number of waivers handled per adviser at any one time
- the number of entities traded per surveillance analyst,
- the average number of trade alerts examined per surveillance analyst
- the average number of queries handled per adviser or analyst
- the number of participants supervised by a compliance adviser, and
- the average number of investigations handled per investigator.

The terms we use might differ but I do think it is possible to construct a list that could quite comprehensively cover what SROs do.

We could stop here or we could venture further.

Should we also be including the resources and infrastructure that support our front line activities? For example, should technology resources and the systems that support supervision, such as the surveillance systems, be included?

There also may be some of us who are structured with legal resources to support front-line supervision. Should we include that in the benchmark?

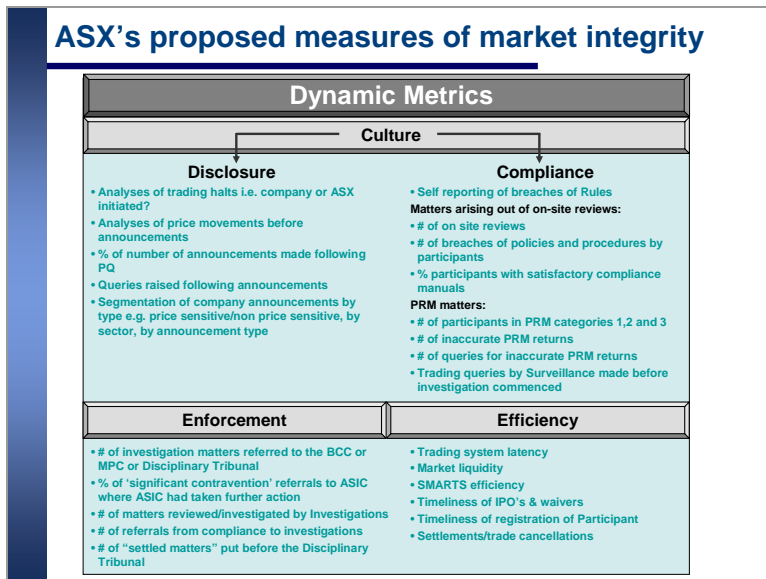
Assuming that we achieve agreement on what should or should not be included, I’m sure you will be thinking, are we comparing like with like? Are our resources performing broadly similar activities? It would be important that the design of the questionnaire considers this issue.

The issues with benchmarking costs are largely similar to that for resources ie what costs to include, how to account for differences in financial reporting methodology, comparability of results and of course, there is the added complexity that costs would be considered by some to be sensitive information.

Market integrity metrics

Having spoken about the “inputs”, I also propose to spend a bit of time on the possibility of benchmarking outcomes.

Again, I should forewarn that the next couple of slides are included as thought starters only. The terminology used is ASX-specific and the measures chosen reflect the tools we have in place to supervise the market.



However, at ASX we have been giving some thought as to what we believe to be the dimensions of market integrity and developing metrics that are proxy measures for them. It is really not the intent of this presentation to run through each measure but to provide a sense of outcomes that might potentially be compared.

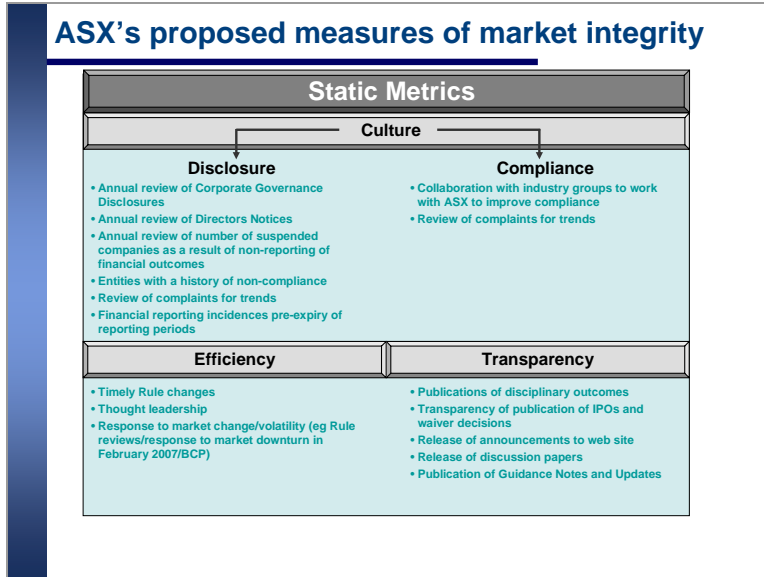
In any event, we tend to look at market integrity from the perspective of –

Culture: The first of these dimensions seeks to assess the culture of disclosure among our listed entities and market participants. The metrics seek to understand better whether companies understand their disclosure obligations – both periodic and continuous. For example, we track whether listed entities make announcements pro-actively or only after we have reminded them of their obligations through a price query – also referred to in our market as a “speeding ticket”.

On the broking side, we track the matters arising from some of the monitoring tools we use. For example, from our on-site reviews we monitor the percentage of participants with satisfactory compliance manuals.

Enforcement: All of us would be familiar with enforcement type metrics which refer to the number of matters we are investigating, the number of referrals made to the Government regulator or to our disciplinary tribunals.

Efficiency: There are potentially several aspects to efficiency. It could refer to the efficiency of our markets and systems or it could include timeliness standards in relation to supervisory functions eg how quickly does it take to process an IPO or a waiver application, or respond to a complaint?



We also distinguish between dynamic and static measures. Dynamic measures change from month-to-month but static measures are likely to be relatively stable. The transparency of how we perform our supervisory function is one example of a static measure. By way of illustration, we could look towards benchmarking the level of transparency in decision making by comparing how quickly we publish a waiver decision after it has been made and the level of detail provided to support the decision. Another static type measure that could be benchmarked is the level of adoption of corporate governance standards by listed entities.

Having provided some possibilities of what could be benchmarked, we are also well aware that there are issues related to how the data might be used for management purposes. As mentioned already, there are the issues of comparability with regards to resources employed and costs across exchanges. With outcomes metrics, we'll have to deepen our understanding on how we interpret some of the measures. For example, would a fewer number of insider trading referrals to the government regulator be an indication that we are "asleep at the wheel" or a sign of a very healthy compliance culture?

Assuming we want to do something, what would be the next step?

Next steps

- **Form a Working Group**
- **Agree scope or phasing of benchmarking**
- **Agree reports to be produced**
- **Appoint independent 3rd party**
- **Agree basis of cost sharing**

1. Form a small working group comprising representatives from:
 - Listed / non-listed exchanges
 - Futures / equities exchanges
 - Small – large exchanges
2. Agree the scope of the benchmarking. Would we benchmark regulatory resources employed in our organisations or should we just compare some market integrity metrics? Or do we do both? If appropriate, we may wish to break it up into phases to enable us to assess the usefulness of the results we are getting after each phase and also to allow us to fine-tune the methodology of the phases that follow.

I expect that in developing the scope, the working group would gain a better understanding of those supervisory activities which are core to participating SROs and a set of measures that could be used to measure these activities.
3. The working group would also recommend the reports that should be produced. Once it has been established what the outputs of the exercise should be, the design of the questionnaire can follow.
4. Given the confidentiality of some of the data that would be provided, we should consider having an independent third party processing the data and collating the results.
5. Lastly, we will need to resolve how the costs are to be shared.

Conclusion

It would be too optimistic to assume that we would be able to resolve all the issues raised in this session and I'm really looking forward to hearing your views on the feasibility and usefulness of a benchmarking exercise. However, it would be good to leave this conference with a sense of whether we have enough interest to go ahead and therefore before beginning our discussion, I would like to finish off with two thoughts:

- I do believe that there could be useful management insights to be gained even in just scoping the benchmarking exercise.
- Secondly, it is my proposition today that if we can demonstrate that we are efficient and effective in the way we regulate the market, our ability to influence outcomes in the exchange space is enhanced.

Thank you



Discussion