



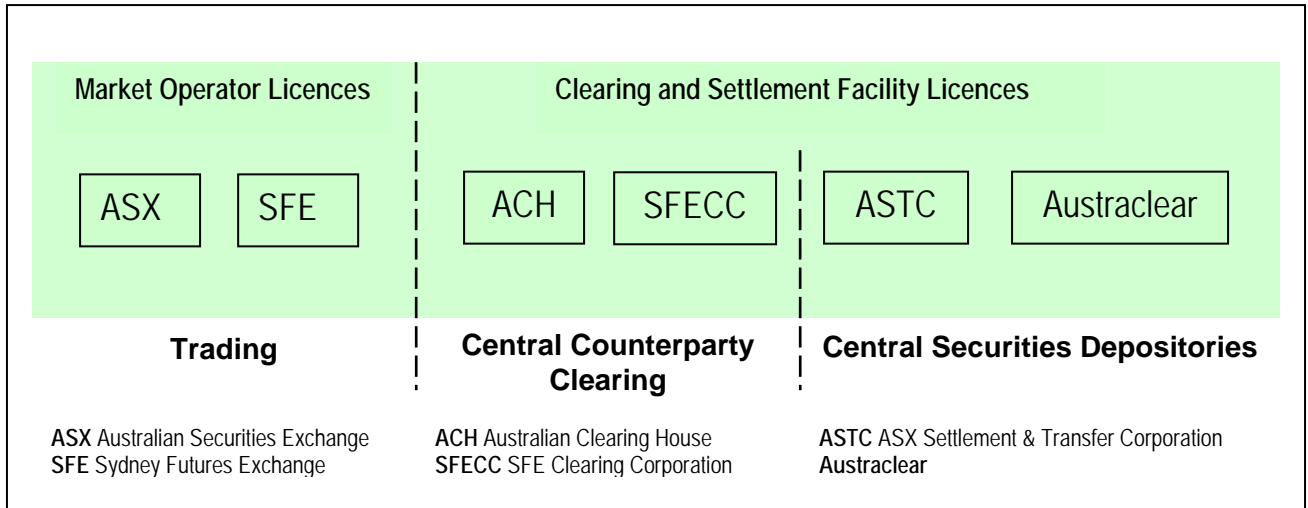
ASX Position Paper

ASX's Role in Australia's Financial Regulatory Framework

June 2008

ASX's Role in the Financial Market Regulatory Framework

The Australian Securities Exchange (ASX) is an operator of financial market facilities and services with six separate licences (one in the listed holding company, ASX Limited, and five in subsidiary companies) as follows:



These companies are licensed to provide these facilities and services to listed companies, brokers and other organisations, subject to regulatory oversight by ASIC and the RBA. Each licensed business has appointed another (unlicensed) subsidiary, ASX Markets Supervision, as their agent to undertake licence obligations involving monitoring of conduct by the organisations to who services are provided by the licensed entities.

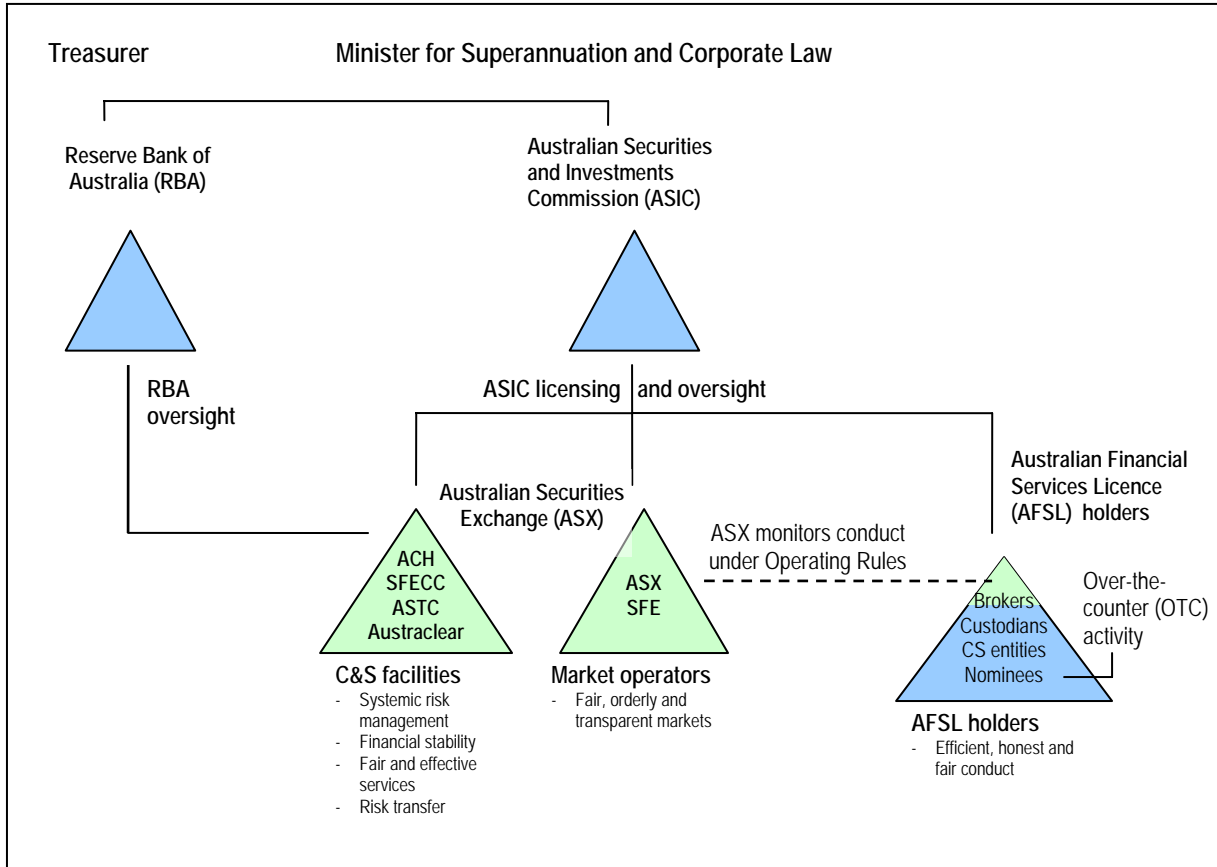
ASX creates multilateral contracts with its direct customers in the form of listing rules, market rules, and clearing and settlement (CS) rules (collectively known as the Operating Rules). Because this contract structure provides the opportunity to shape the behaviour of market users, the Operating Rules are recognised in the Corporations Act. The Corporations Act sets out minimum content requirements for the rules. For example, the rules must deal with matters including admission, and ongoing conduct of Participants.

The law provides that these multilateral contracts cannot be changed without governmental oversight. This takes the form of a requirement that the relevant Minister, currently the Minister for Superannuation and Corporate Law, be given an opportunity to take the advice of regulatory agencies, such as ASIC, about the merits of ASX's proposed rule changes and, in extreme cases, disallow the proposed rule changes.

The rules exist primarily to identify the services that are being offered by ASX. The rules set out the terms on which ASX operates its markets and facilities and provides related services, the way those facilities and services operate, the roles of each party, as well as the rights and obligations of entities that participate in those markets and use these services (market infrastructure). The Operating Rules are also one of the main tools that a market licensee uses to meet its obligations to ensure that the market is fair, orderly and transparent (market standard-setting).

ASX monitors conduct in accordance with both the terms of its licences and the terms of its Operating Rules. On this basis ASX can be distinguished from APRA and ASIC, which are government agency regulators with regulatory powers conferred by Government. ASX is neither a financial services regulator

(like ASIC) nor a prudential supervisor (like APRA). ASX is best characterised as a regulated entity with some supervisory functions as detailed below:



Market Rules

Market Participants (brokers and other intermediaries) enter into a contractual relationship with ASX to comply with the market rules. The following table provides clarity around what ASX does and does not do in relation to its market rules:

ASX does...	ASX does <u>not</u> ...
✓ Establish rules for the admission, expulsion and ongoing obligations of Market Participants.	✗ Regulate related bodies-corporate, associated entities, or third-party contracts entered into by Participants.
✓ Monitor Participant conduct that directly impacts on the market: eg monitor compliance with ASX's client order priority rules and crossing rules.	✗ Regulate conduct by brokers, financial advisers, financial planners or any other AFSL holders in relation to OTC activities including margin lending, securities lending/borrowing, etc. Regulate or supervise the activities of non-ASX Participants in any way.
✓ Conduct real-time market surveillance to	✗ Determine what the law is, or monitor

ASX does...	ASX does <u>not</u> ...
detect market manipulation, insider trading, front-running, breaches of continuous disclosure and other illegal activity that impacts on ASX's markets.	trading on any other market or OTC activity.
✓ Refer possible illegal activity to ASIC for ASIC's consideration of investigation and prosecution.	✗ Investigate and prosecute companies or individuals for breaches of the law.
✓ Establish and monitor Market Participant capital liquidity requirements.	✗ ASX does not purport to prevent insolvency of brokers or to provide comfort to clients of brokers as to their broker's financial position. ASX's involvement in setting capital liquidity requirements are directed at the quite separate issues of the stability of the Australian clearing system and hence, ASX's own financial exposure as central clearing counterparty to that group of organisations that are participants in ASX's clearing house. One of the many layers of management of these counterparty risks involves a liquidity requirement directed at maximising the prospect that participants in ASX's clearing organisations will be able to convert capital into cash inside 30 days. The fact that a trading participant that does not clear its own trades becomes insolvent within days of having represented that it satisfies such a liquidity requirement does not represent a regulatory failure.

Clearing and Settlement Rules

An organisation that uses ASX's CS facilities enters into a contractual relationship with ASX to comply with the CS rules. The following table provides clarity around what ASX does and does not do in relation to its CS rules:

ASX does...	ASX does <u>not</u> ...
✓ Novate* on-market cash equity and equity derivative trades, with ACH acting as central counterparty.	✗ Novate all trades in ASX-listed financial products. Approximately 25-30% of equity trades reported to ASX are off-market, bi-lateral trades. These are not novated.
✓ Novate on-market traded derivatives, with SFECC acting as central counterparty.	✗ Provide individuals with financial advice on the most appropriate derivative products or risk exposure for their circumstances.
✓ Provide settlement services for both on-market novated trades, and off-market	✗ Monitor or supervise bilateral OTC contracts between Market Participants or

ASX does...	ASX does <u>not</u> ...
bilateral trades in ASX-listed products.	other AFSL holders.

*Novation is the process whereby ASX's clearing house becomes the counterparty to every buyer and seller, effectively ensuring the performance of every on-market transaction.

Listing Rules

Similarly, listed entities (trusts and companies) enter into a contractual relationship with ASX to comply with the listing rules. The following table provides clarity around what ASX does and does not do in relation to its listing rules:

ASX does...	ASX does <u>not</u> ...
✓ Establish rules for the admission, expulsion and ongoing quotation of securities by listed entities.	✗ Regulate the activity of listed entities generally: eg regulate takeovers, mergers and acquisitions, or other corporate activity.
✓ Facilitate the release of information to the market, including material company announcements, director interest notices (DINs) and substantial shareholder notices (SHNs).	✗ Determine what specific information is material to a listed company, or anticipate when a shareholder has an obligation to lodge a SHN or DIN.
✓ Provide safeguards for investors to enhance the attractiveness of ASX's markets: eg shareholder approval requirements for capital raisings, and requirements for periodic reporting.	✗ Audit or otherwise guarantee the accuracy of information provided by listed entities to their shareholders and the market.
✓ Promote good governance practices and shareholder engagement via its participation in the ASX Corporate Governance Council.	✗ "Control" the Corporate Governance Council. ASX provides the Council secretariat and Chair, but is otherwise one of twenty-one Council members. Other members represent different business, shareholder and industry groups.
✓ Require an entity to report its governance practices on an "if not, why not" basis in response to the ASX Corporate Governance Council's Corporate Governance Principles and Recommendations.	✗ Prescribe black letter governance practices: eg determine what business activities a listed entity can carry out, or what corporate structure a listed entity adopts.

Operating Rules

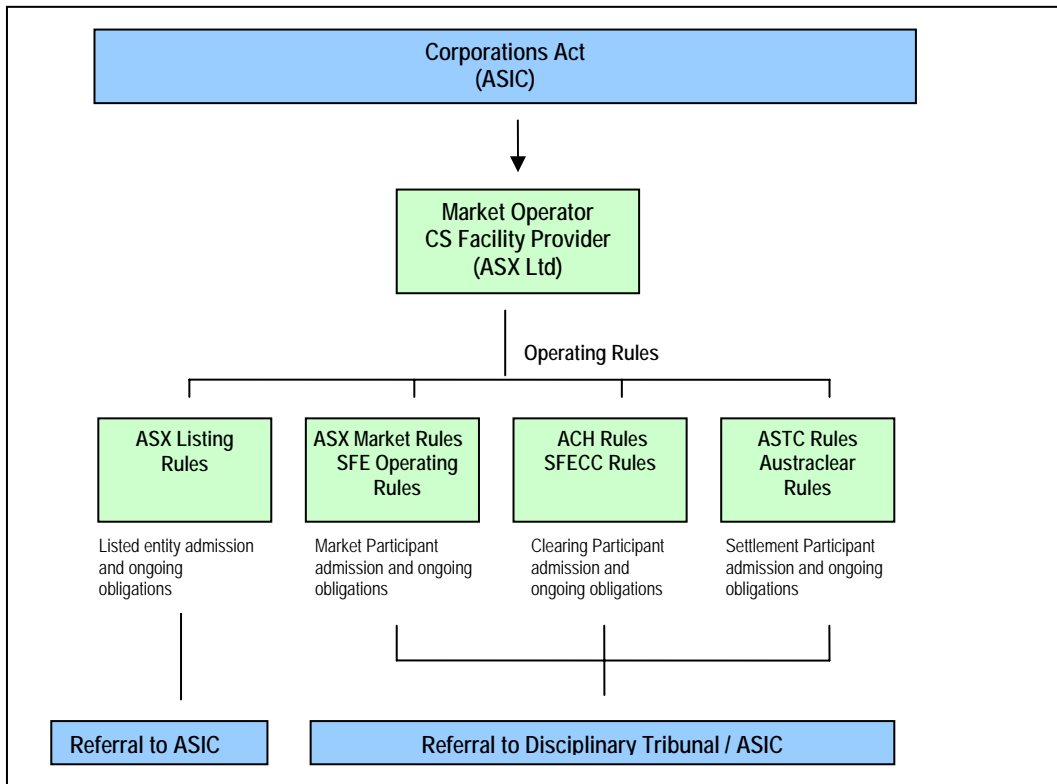
ASX's Operating Rules contain standards of conduct that are specific to ASX's markets. The Operating Rules focus on:

- Ensuring prices obtained on ASX's markets are a reflection of genuine supply and demand;
- Information disclosure, so that information reflected in the prices at which transactions occur is reliable;

- Providing transparency, so that market users know with some degree of certainty whether, and at what prices, they can deal and can know the prices and volume of all individual transactions concluded;
- Balancing the interests of all market users so that no market users are favoured over others;
- Requiring Participant compliance with the terms of the multilateral contract; and
- Structural CS arrangements to reduce systemic risk.

A breach of the rules is first and foremost a breach of the contract between an entity and ASX. When entering into a contract with ASX, an entity confers upon ASX contractual remedies, including the ability to refer a Participant to a Disciplinary Tribunal, to suspend an entity from trading, clearing or settlement activity or to remove an entity's securities from official quotation. Some conduct may simultaneously result in a breach both of ASX rules and legislation. Where this is the case, it is possible that both ASX and ASIC will exercise their respective rights to take action in response to the breach. Legislation sets out Government (and community) public policy. A breach of legislation may result in civil or criminal action.

ASX's Operating Rules are not the same as legislation. However, their importance is acknowledged by the recognition given to them in the Corporations Act. ASX establishes its Operating Rules in consultation with market users and these are subject to oversight by ASIC and disallowance by the relevant Federal Government Minister (currently the Minister for Superannuation and Corporate Law). This framework is set out below:



ASX Market Monitoring

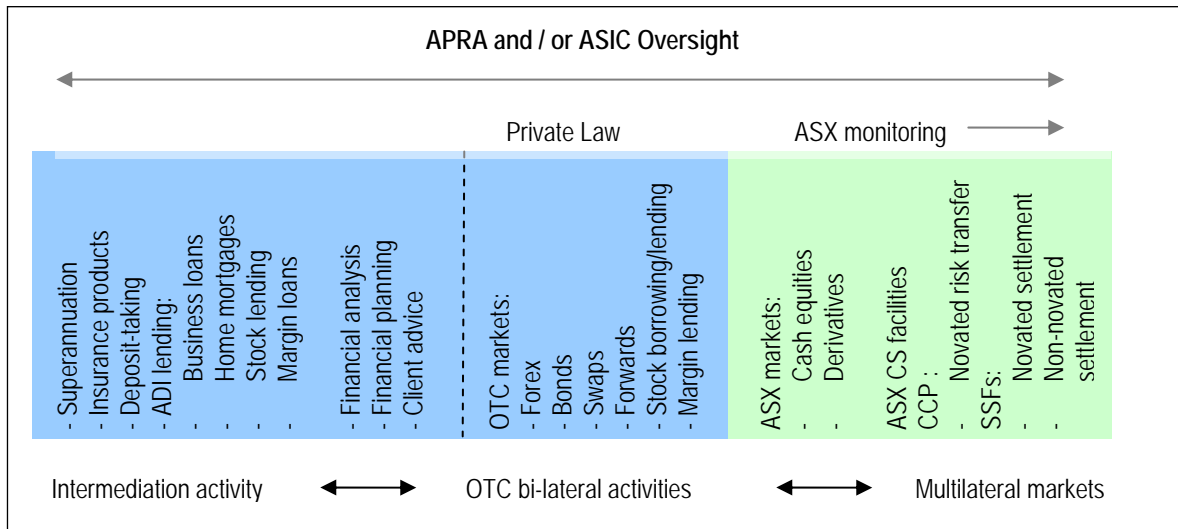
ASX does not have delegated responsibility to 'regulate' or 'supervise' Participants or listed entities' compliance with the law. As a licensee, ASX is obliged to monitor conduct in relation to the markets and facilities it operates, to supervise the market and ensure compliance with its rules, and to refer to ASIC any suspected breaches of the law. Nor does ASX exercise oversight of a Market Participant's compliance with contracts with other third parties, such as in relation to funding or lending arrangements.

ASX is not obliged to, and nor does it, oversee all aspects of a Participant or listed entity's business. A corporation could undertake a range of activities. A typical corporate group structure may comprise a number of corporate entities, each responsible for undertaking discrete businesses. The choice of structure is one for the corporate group to determine. It is not uncommon for an ASX Participant to be one part of a larger corporate group.

ASX's oversight of Participants is confined to monitoring those aspects of their business that directly relate to compliance with ASX's Operating Rules, or with the operation of ASX's markets or facilities. In practice, ASX only has the ability to oversee the relevant dedicated subsidiary (the Participant) which undertakes trading activity on ASX's markets and which uses ASX's CS facilities.

Thus, where a broker engages in OTC activity and enters into third party contracts – stock borrowing/lending (for equities or fixed income securities), re-purchase arrangements, margin lending, etc, these are not activities that are supervised or monitored by ASX.

ASX monitoring is in addition to the regulatory functions carried out by ASIC and APRA. The extent of Government regulatory oversight will be a product of the functions undertaken by the entity. Activity such as deposit-taking or lending arrangements is subject to APRA and ASIC oversight; multilateral activity (trading, clearing and settlement) on ASX's markets is monitored by ASX, subject to Government agency regulatory oversight.



Conclusion

ASX monitors compliance with its rules and, if necessary, instigates enforcement action in respect of rule breaches: for example, by referring the suspected breach of a market rule by a Participant to its Disciplinary Tribunal, to ASIC, or to both. ASX also undertakes other market monitoring necessary to ensure that it is providing a market of integrity within the constraints of its powers.

The Operating Rules exist primarily to identify the services that are being offered by ASX. The rules set out the terms on which ASX operates its markets and facilities and provides related services, the way those facilities and services operate, the roles of each party, as well as the rights and obligations of entities that participate in those markets and use these services (ASX's market infrastructure).

ASX monitors conduct in accordance with both the terms of its licences and the terms of its Operating Rules. ASX has a vested interest in ensuring that it operates markets of maximum integrity – it is integral to ASX's long-term commercial success. For this reason, ASX would continue to undertake activities consistent with these objectives even in the absence of its licensee obligations.