

MARKET SUPERVISION REGULATIONS

- *Treasury Consultation and Exposure Draft Corporations Regulations May 2010 (Infringement Notice regime; Transitional matters; consequential changes)*

Submission

Executive Summary

The Stockbrokers Association **supports** the draft regulations which should facilitate the smooth transition from ASX regulation to ASIC.

However, we wish to raise a **serious concern** in relation to the power of ASIC to enforce the Market Integrity Rules against **individuals**, which is a power that does not presently exist under the ASX regime.

Introduction

The Stockbrokers Association of Australia is the peak industry body representing institutional and retail stockbrokers and investment banks in Australia. The Stockbrokers Association is pleased to provide this submission to Treasury on the Exposure Draft and Commentary – *Market Supervision Regulations* issued in May 2010.

The Regulations give more detail of the actual operation of market supervision by ASIC, after it takes over the market supervision function from ASX, which is expected to occur in August 2010. It has been the stated aim of ASIC and the Government that the transition should be as seamless as possible, causing minimal disruption to our Members' businesses.

Our comments will concentrate on that part of the new Regulations covering Supervision of Financial Markets: Part 7.2A. These regulations cover the enforcement of the ASIC Market Integrity Rules (**MI Rules**). The main tools available to ASIC to enforce its MI Rules are **Infringement Notices** and **Enforceable Undertakings**.

Some of the key features of the new Infringement Notice and Enforceable undertaking regimes are as follows:

- **Infringement Notices:**
 - ASIC can issue infringement notices against entities for breaches of the MI Rules.
 - The infringement notice must set out the reasons for the breach, and the penalty, which must not exceed three-fifths of the penalty in the MI Rules for that rule
 - The entity has 27 days in which to comply with the notice
 - The entity can during that time apply to have the notice withdrawn
 - If the notice is not withdrawn, and/or not complied with, ASIC can then seek to enforce it in Court by way of a civil penalty action. This is the same as the continuous disclosure regime.
- **Enforceable Undertakings:** as before, enforceable undertakings can be given to ASIC to resolve disciplinary matter
- **Transitional arrangements:** all lodgments with ASX and waivers, accreditations and consents given by ASX prior to handover to ASIC will have effect after the handover as if they were lodged with or given by ASIC. We welcome this provision, which should assist in minimising the disruption to our Members' business after the handover to ASIC.
- **Markets Disciplinary Panel:** we are consulting with ASIC on the operation of its Market Disciplinary Panel and note its Consultation Paper 136 on this subject.

ISSUE: Action against Individuals for breach of the MI Rules

As previously noted, the stated aim of the transition from ASX to ASIC has been to minimise change and disruption for our Members who are market participants. It is of great concern therefore, that it appears that the disciplinary powers of ASIC under the MI Rules is much broader than those under ASX.

Under the *Corporations Act* section 798H¹, the following entities must comply with the MI Rules:

- *market operators*
- *market participants², and*

¹ as inserted by the *Corporations Amendment (Financial Market Supervision) Act 2010*

² There is an argument that the MI Rules should apply more broadly. There is a growing sector of financial services providers providing like services to stockbrokers without themselves being participants of an exchange. Advances in technology and flexible business models mean that from the clients' point of view these firms are providing all the services that a stockbroker provides, but without

- **entities** prescribed by the regulations.

For the purposes of section 798H, draft Regulation 7.2A.01 defines those **entities** that must comply with the MI Rules as:

- *employees*
 - *representatives*
 - *agents, and*
 - *contractors*
- of participants in licensed markets.*

Like the current ASX rules³, the MI Rules may include a maximum penalty for their contravention of \$1,000,000⁴. Penalties can also include other measures, similar to the measures which are available to the ASX Disciplinary Tribunal, like education programs, censure, suspension and disgorgement of profits⁵.

The **real concern** is that the list of **entities** against whom the MI Rules can be enforced is much broader than under the ASX rules. The ASX rules can only be enforced against the Participant. To a limited extent, pre-handover, ASX rules can also be enforced against individuals registered as Responsible Executives and Designated Trading Representatives, but only to the extent that they can be banned or suspended from these roles. After hand-over, these individuals will come under the jurisdiction of ASIC. The Tribunal can also order that a participant exclude a person from its business or change the person's duties⁶, but such an order is against the firm, not the individual. It remains the case that there is no power to fine RE's, DTR's or any other individuals.

(In 2004 with the introduction of the Responsible Executive regime for ASX participants, ASX proposed that it have the power to fine RE's directly. At the time, we raised concerns as to whether it was fair, equitable or proportionate to have the power to levy a fine of what was then up to \$250,000 against a major broking firm on the one hand, and an individual who was registered as an RE on the other. In the event, ASX dropped its proposal, so that only the firm itself could be fined. We would hope that a similar approach could now be taken.)

Under the draft Regulations, it would appear that ASIC can enforce the MI Rules against **employees, representatives, agents and contractors** as well as the Participant itself. This substantially broadens the scope of the MI Rules, so that for example, a Responsible Executive, manager, compliance officer or adviser could be fined up to \$1,000,000.

the additional regulation and consumer protection provided by the Market Integrity Rules. We trust that this issue is revisited in the near term, as it does appear to be a gap in the regulatory landscape ó a gap that can be readily filled now that ASIC and not ASX will be the responsible regulator.

³ ASX *Disciplinary Processes and Appeals Rulebook* Rule 2.4.1

⁴ Section 798G(2)

⁵ Draft Regulation 7.2A.03(1)

⁶ ASX *Disciplinary Processes and Appeals Rulebook* Rule 2.4.1(f)

The prospect that a whole new set of individuals – theoretically *anyone* working for or by arrangement with a Market Participant – could be subject to a \$1,000,000 fine has sent **shockwaves** through the industry. It is doubtful whether such liability can be covered by insurance or indemnity from the Participant. Once again, we cannot see how it is fair, equitable or proportionate to have the power to levy a fine of up to \$1,000,000 against a major broking firm on the one hand, and any individual within the firm on the other. We trust that – like the earlier proposal by ASX to fine RE’s mentioned above – a sensible balance can be reached which recognises the weaker position of individuals vis-à-vis their firms and achieves a better degree of proportionality for offences.

Having said that, and notwithstanding the expanded definition of entities that are subject to the rules, it appears that the MI Rule themselves impose obligations on the market participant, not on individuals. We would therefore query how a representative can in fact contravene a rule which is not expressed to apply to them.

This matter was raised with ASIC at the 2010 Annual Stockbrokers Conference in Melbourne this week and there was a suggestion that there could be some narrowing of the rules by ASIC so that only certain rules could apply to individuals.

However, rather than relying on ASIC to change its MI Rules and leaving the Regulations as they stand - imposing liability on individuals to comply with the MI Rules - we would submit that it would better if **the Regulations themselves could make it clear that it is not the intention to use the enforcement powers directly against an individual who has, as an employee, agent or contractor been involved in the contravention itself.** If misconduct is found on the part of an individual, ASIC has the power – as it always has - to take banning order and/or criminal action against that person.

We are grateful for the opportunity to raise these matters in the process of the promulgation of these important regulations, as we have during the whole transition process. Please contact Doug Clark, Policy Executive if you have any queries or if we can be of any further assistance.

STOCKBROKERS ASSOCIATION OF AUSTRALIA

11 June 2010