COMMONWEALTH OF AUSTRALIA

JOINT COMMITTEE

on

CORPORATIONS AND SECURITIES

(Reference: Statutory monitoring role: role of the Companies and Securities Advisory Committee

CANBERRA

Monday, 27 March 1995

OFFICIAL HANSARD REPORT

CANBERRA

JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

Members:

Mr Stephen Smith (Chair)
Senator Gibson (Deputy Chair)

Senator Cooney	Mrs Bishop
Senator McGauran	Mr Humphreys
Senator Neal	Mr Sinclair
Senator Spindler	Mr Tanner

Matter referred:

Statutory monitoring role: role of the Companies and Securities Advisory Committee.

WITNESSES

BYRNE, Ms Karen Leslie, General Counsel, Australian Stock Exchange Ltd, 20 Bond Street, Sydney, New South Wales 2000 39

HUMPHRY, Mr Richard George, Managing Director and Chief Executive Officer, Australian Stock Exchange Ltd, 20 Bond Street, Sydney, New South Wales 2000 39

WHITE, Mr David John, Director, Derivatives and Market Development, Australian Stock Exchange, 20 Bond Street, Sydney 2000 39

JOINT STATUTORY COMMITTEE ON CORPORATIONS AND SECURITIES

Statutory monitoring role; role of the Australian Stock Exchange

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Monday, 27 March 1995

Present

Mr Stephen Smith (Chairman)

Senator Cooney	Mrs Bishop
Senator Neal	Mr Sinclair
	Mr Tanner

The committee met at 10.14 am.

Mr Stephen Smith took the chair.

CHAIR—This public hearing of the Joint Parliamentary Committee on Corporations and Securities is part of the committee's program of regular hearings with the Australian Stock Exchange under the committee's statutory role in overseeing Australia's companies and securities law. These hearings are a regular feature of the committee's hearing program and assist the committee and the parliament to get a detailed, up-to-date picture of the ASX's activities. This hearing comes reasonably soon after the collapse of Baring Brothers and is of obvious interest to the committee and the parliament in terms of the ASX's role in derivatives trading in Australia.

[10.15 a.m.]

BYRNE, Ms Karen Leslie, General Counsel, Australian Stock Exchange Ltd, 20 Bond Street, Sydney, New South Wales 2000,

HUMPHRY, Mr Richard George, Managing Director and Chief Executive Officer, Australian Stock Exchange Ltd, 20 Bond Street, Sydney, New South Wales 2000, and

WHITE, Mr David John, Director, Derivatives and Market Development, Australian Stock Exchange, 20 Bond Street, Sydney 2000,

were called to appear before the committee.

CHAIR—I welcome the Managing Director of the Australian Stock Exchange, Mr Richard Humphry, and other officers of the Australian Stock Exchange. We are pleased to see you again, Mr Humphry. In accordance with our usual practice, if you would like to make an opening statement we can commence proceedings in that way.

Mr Humphry—Thank you, Mr Chairman. I would like to make an opening statement. We appreciate this opportunity of appearing before the committee and, I hope, of helping to clarify some important issues affecting the securities industry. One of the matters that we discussed last time was how ASX might introduce disclosure of corporate governors' practices into its listing rules. We are well advanced on that. In fact, our full board will be meeting tomorrow to decide on the final shape of the new rule. Given that a final decision has not yet been made, I would be happy to bring the committee up to date on that particular subject.

Since we were here last, we have also witnessed the Barings collapse, which has focused attention particularly on derivatives as distinct from the underlying asset markets themselves. I would therefore like to make a few preliminary comments on derivatives from the point of view of the Australian Stock Exchange.

The ASX has been in the derivatives business for a long time, at least by the

standards of this relatively new type of market. We founded the Australian Options Market back in 1976, only three years after the concept of exchange floated options was first developed in the United States. Today it is one of the largest equities options markets in the world. With me today is Mr David White, who is the National Director for derivates at the ASX.

We have nearly 20 years experience in derivatives trading, which includes the market break in 1987, a far more traumatic event, we suggest, than the Barings collapse and one that completely overwhelmed the Hong Kong Futures Exchange at the time. In all that time, no-one has lost money on our derivatives market through broker default. That is persuasive evidence that we operate a very well-regulated market.

There have been some inaccurate comments made recently about ASX's derivative market being subject to only voluntary regulation. That is absolutely incorrect. There is nothing voluntary about it. The business rules under which all our markets operate are enforceable, not only as a contract between ASX and the stock broker members but specifically under section 777 and section 11(14) of the Corporations Law. It is also important to recognise that our business rules themselves are subject to disallowance by the Attorney-General if he is not satisfied with them. Furthermore, our whole regulatory structure is reinforced by a series of memorandums of understanding with the Australian Securities Commission. We also meet regularly with the Sydney Futures Exchange in a number of forums to coordinate our activities in those areas of non-competitive subjects such as market security.

There has also been a lot of talk about chapter 7 versus chapter 8 of the Corporations Law and the alleged gulf between them, but the fact is that the two chapters have many common features. In both cases, they do not stand alone but are supplemented by the various exchanges' business rules. To the extent that they do diverge, which is largely for historical reasons, there is no basis at all for claiming that one is superior to the other. They both provide a thorough and rigorous regulatory regime.

We have prepared a written summary of the differences between the two chapters. We have provided copies for your information. This is the particular document which has

been prepared under direction from Karen Byrne, General Counsel and head of the ASX legal branch, who is here today. We have set it out in a way which we thought would assist the committee in differentiating between the various requirements under both chapters.

The real problem, I would suggest, is that we have a chapter 7 and a chapter 8 at all and the threat of a chapter 9, if someone dreams up a sufficiently different product from either options or futures. Perhaps we should be thinking along the lines of having a single generic chapter of the Corporations Law dealing with markets, with different products being dealt with by the much more flexible route of regulation—still, of course, subject to parliamentary scrutiny. There is no reason at all why that approach should lead to less well-regulated markets, but it would make innovation a lot easier and product innovation is one of the keys to the Australian markets competing successfully with the rest of the world, which is another concern of this committee.

It is certainly preferable to spending industry money arguing in court whether chapters 7 or 8 apply to a new product, because court cases have unpredictable consequences. We bring to the committee's attention the fact that the full bench judgment that cleared our low exercise price options had the incidental effect of ruling that deliverable share futures, which the Sydney Futures Exchange was proposing to introduce, were illegal. This new product of theirs will only be saved by the legislation authorising share ratios currently before the parliament which, ironically, they also opposed.

We are all for competition in markets. We think it leads to better products, greater efficiency and improved supervision, but it does not work as well as it should when there is an ambiguous regulatory environment to consider. However the law might be framed, ASX takes its regulatory responsibilities very seriously indeed and the requirements that we impose on participants in the derivatives market are quite stringent.

We are prepared, of course, to go into details if you wish, but let me outline them very briefly for you. We set strict capital adequacy requirements for brokers and monitor that compliance. We require every options transaction to be registered so that no trades can be concealed. We impose strict limits on the size of the options position any one

client can have and on the total number of contracts that can be open over any one company's shares.

We have a computer based margining system, which is also used by other major equities options markets around the world. Every trading day, this system calculates both risk margins based on the effects of a worst case overnight movement in the market, plus margins to cover actual daily movements in the market, plus additional margins during the course of a trading day. If there is substantial market movement, these margins must be paid or we close out the contract. We do not just monitor the activities of brokers either. We also monitor every single one of their clients. We are one of the very few exchanges in the world to do so, to account down to the individual client level, and we are the only one in Australia.

We have a separate computer based risk mismanagement system and if we find a broker has what we believe to be an unacceptable exposure, we ask the broker to close out the relevant contracts or inject further capital. In the event of default, we have the power to transfer positions or close out the broker's position. We have the same right to close our client positions.

We also have one of the most sophisticated market surveillance operations in the world, which some of you have seen first hand at the exchange and which I would extend an invitation to all members of this committee to visit the exchange to view. It continuously monitors not only the equities market but also the options market for any sign of untoward activity. We swap that surveillance information with the Sydney Futures Exchange because they trade a futures contract over one of our share price indexes.

One of the major lessons of the Barings collapse with derivatives markets is the necessity for efficient risk management systems, proper reporting requirements and market to market accounting. As I have indicated these are already features of the ASX's derivatives markets.

Participants in the options market also have the protection of the national guarantee fund. This is operated under part 7(10) of the Corporations Law and has assets of $130 million. If that is exhausted, the fund can levy ASX, which has net assets of $120 million,

and levy all of ASX's stockbroker members, who collectively have net assets of a further $580 million. So I would reject any suggestion that the protection afforded the participants in the ASX derivatives market is inadequate. On the contrary, it is at the level of world best practice and I believe it is unmatched by any other market in Australia. We certainly have a well-deserved reputation around the world these days for our high regulatory standards.

The final derivatives issue I would like to mention briefly, although I am sure you are well aware of it, is that we are actively introducing new derivative products on our options market because we believe there is a demand from our customers for them. Currently we have share ratios and low exercise price options, or LEPOs, in their final preparatory stages. No other financial instruments in Australia have been subjected to such rigorous examination before their introduction by regulators, by investors and not at least by our competitors and the courts. It has been an exhaustive and exhausting process, but we do fully support the Australian Securities Commission in its determination to ensure that any instrument being made available on exchange traded markets meets proper standards of probity and investor protection, and these two instruments certainly do.

I would like to return for a moment to Barings. One other lesson from its collapse is the importance of separating trading activities from the back office accounting function in order to provide independent checks. This is our clear policy. It is a fundamental tenet of any operation of checks and balances that there be a separation and we are impressing it on our stock broker members as part of our regular inspection program. We would not tolerate a merger of the two functions.

Our present view is that the current audit checks and compliance program are sufficient assurance of separation, but we are considering whether a specific rule backed up by penalties would reinforce that policy. The final lesson from Barings is a more general management one, and I am perhaps more sensitive to it as a former auditor-general. It appears that the Barings collapse would not have happened if there had been appropriate disclosure or appropriate segregation of duties, appropriate responses to audit warnings and observance of basic prudential standards of financial management.

We are responding to the lesson from Barings. In particular, we have proposed to the Australian Securities Commission that a derivatives consulting group should be established, bringing together the major organisations involved in all types of derivatives trading as well as the ASC and the Reserve Bank as respective regulators. Its primary purpose would be to develop measures that would minimise the prospect of a Barings situation occurring in Australia in any market. In conclusion, I stress how important it is to recognise the importance of derivatives because they are an essential mechanism for investors to be able to manage risk.

CHAIR—Thanks very much for that comprehensive opening statement. The committee will ensure that the work on chapter 7 and 8 is incorporated in its papers. The one issue that you did not deal with in detail is, of course, the corporate governance issue. I might commence with that. I think the last time we spoke, which was September last year, you talked about producing a discussion paper, which you did, and you asked that responses to your discussion paper be out by 9 December last year. In the first couple of pages of that discussion paper you referred to:

On 1 June 1994, the exchange announced that it wished to take a leadership role in helping to promote corporate governance standards for listed companies.

On page 2 you stated:

The basic framework of the discussion paper was the proposed that the ASX adopt a listing rule which requires each listed company to include in its annual report a statement as to whether the company has followed, throughout the reporting period, the practices set out in the schedule of corporate governance practices. A company that has not followed all of the practices or has followed them for only part of the reporting period must identify those practices not followed and give reasons for not following them.

That was obviously a proposed listing rule which was based on the London Stock Exchange requirement following the Capri committee report. So that is where you were September or December, can you give us an update to see where you might arrive finally tomorrow?

Mr Humphry—Yes, I am happy to do so. In all, we received from that process, 76 submissions of which 58 per cent supported the proposal as put to them. Perhaps more importantly though, 80 per cent of the respondents supported a disclosure of corporate governance practices, but the additional numbers had some reservations about the degree

of prescription of the process.

We took the trouble to interview a large number of the respondents and I would be happy to table the breakdown of those who responded and their particular interests. It may be of some use to the committee to be aware of the breakdown. We received 11 submissions from accountants or from those in the legal profession. There were only three submissions from investor groups, but that was intended to represent the industry as a whole. Three submissions were received from business groups. Listed companies submitted 47 submissions and we received 10 others.

In all, of those 74 responses, 43 or 58 per cent were for as the submission stood and 31 were against it. But as I say, of the 31 against, when we followed those up, it turned out that the majority of those were in favour of disclosure, but they were concerned about the degree of prescription and the reason for that was that they were concerned about a focus being more on form rather than on substance. I must stress to the committee that this matter is still to go before the full ASX board. What I can give you are my recommendations that will be made to the board. I have discussed that matter with our chairman and deputy chairman, who have agreed with my discussing this matter with this committee.

We found that there was some divergence of views on consensus of what would be best corporate governance practice and how to cope with emerging issues. What we set about doing was to try to find a solution that would ensure that there was adequate disclosure and transparency of corporate governance processes that match with an environment which would enable emerging issues in corporate governance to be picked up as well. What we have done is to set about establishing a draft listing rule, which says that the ASX listing rules are expected to provide for reporting by listed companies on their corporate governance practice. It goes on to say that a listed company must, in its annual report, include:

> . . . a statement of the main corporate governance practices that the company has had in place during the reporting period. Where the statement identifies a corporate governance practice that has been in place for only part of the reporting period, the part of the period for which it has been in place must be disclosed.

It goes on to say:

To assist companies, an indicative list of corporate governance matters is set out at Appendix 33.

The only differences that really apply is to the degree of prescription. So, in tackling that issue, we set out eight items that we thought were matters that every company should address when providing their information on corporate governance. By the way, we intend to maintain the listing rule on requiring an audit committee to be maintained by each corporation. We believe that is essential. The list of corporate governance practices identified are:

1. Whether individual directors, including the Chairman, are executive or non-executive directors.
2. The main procedures that the company has in place for—
    i. devising criteria for board membership,
    ii. reviewing the membership of the board, and
    iii. nominating directors.

If any of these procedures involve a nomination committee, a summary of the main responsibilities of the committee, and the names of committee members. If one or more members are not directors of the company, their positions in the company.

We are not trying to say, 'Do you have a nomination committee?' Rather, we are trying to say, 'How do you handle a function of devising criteria for board membership or for nominating directors?' If you do use a nomination committee, which may be considered by some to be best practice, then how does that operate? The concept is: if you have a different mechanism, we want to hear about it.

Mr SINCLAIR—Do you draw any distinction between executive and non-executive directors?

Mr Humphry—Yes, it is point No. 3. That is a good point. It goes on:

3. The company's policy on the terms and conditions relating to the appointment and retirement of non-executive directors.
4. The main procedure(s), if any, by which directors in the furtherance of their duties can seek independent professional advice at the company's expense.
5. The main procedures for establishing and reviewing the compensation arrangements for—
    i. the Chief Executive Officer and other senior executives, and
    ii. non-executive members of the board.

Mr SINCLAIR—What do you mean by compensation? That is retirement benefits.

Mr Humphry—It is any form of monetary compensation.

Mr SINCLAIR—Including share issues and entitlement to options and so on?

Mr Humphry—Yes.

Mr SINCLAIR—Is that specifically mentioned?

Mr Humphry—We use the word 'compensation arrangements', meaning any form of monetary payment that is made to them.

Mr SINCLAIR—Yes.

Mr Humphry—It goes on:

If these procedures involve a remuneration committee, a summary of the main responsibilities and core rights of the committee, and the names of committee members. If one or members are not directors of the company, their positions in the company.

6. The main procedures that the company has in place for—

i. the nomination of external auditors, and

ii. reviewing the adequacy of existing external audit arrangements, with particular emphasis on the scope and quality of the audit.

If any of these procedures involve an audit committee, a summary of the main responsibilities and core rights of the committee, and the names of committee members. If one or more members are not directors of the company, their positions in the company.

We make the cross-reference there to rule 3C(3)(i), which requires an audit committee to be in place. It goes on:

7. The Board's approach to identifying areas of significant business risk and putting arrangements in place to manage those risks.

8. The company's policy on the establishment and maintenance of appropriate ethical standards.

As I say, this is to go before the full board for consideration, but the key to this is to try to establish a regime which draws out from companies their approach to corporate governments. We do require that they do describe it. The concern we had was how to avoid getting into a situation where people tick boxes and actually gave consideration to the judgments that they brought to bear.

We also are aware through our discussions with the Investment Managers Association that they are giving consideration to putting out their own guide to corporate governance practices which would then guide the institutional investors, and we would see that as complementing the matter. I believe that if the board agrees to this approach to corporate governance it would be appropriate for us to review the success or otherwise of

it within about 12 months or so. So that is where we are.

CHAIR—Thank you very much for that. I understand in a sense the difficulty you are in with the board meeting tomorrow, and I am appreciative of the fact that the chairman has authorised you to outline what your recommendation to the board will be. The first problem, if you like, I think is a perception one. The framework appears to be a substantial diminution from the proposal circulated in the discussion paper and, in an area where perception is all important, do you believe it will be perceived as a substantial diminution and what will you do to try and remedy or effect that?

Mr Humphry—I actually do not see it as a diminution. The issue for me is how do we ensure that companies do disclose fully but, at the same time, we do not put them into what one could call some sort of box which we describe as best practice. The difficulty with that is, if we are fully prescriptive, then I am sure that what will happen is that people will tick off the particular items but they will not disclose things or have initiative to move into areas where there are no listing requirements or specific listing requirements given. What we are really after is trying to find out from them how they achieve an outcome, and not the process that they go through to achieve the outcome. So we believe that this approach will address that in a much more effective way. That is our opinion.

CHAIR—Yes. I accept your position's argument, and in fact you get some comfort from it from the chairman of the Australian Securities Commission, Mr Cameron, who we will be seeing on Wednesday. In a speech reported in the *Financial Review* in October of last year he says that corporate governance issues should steer clear of the check list mentality. And he is quoted as saying:

> I have yet to be convinced that operating by way of a series of prescriptive check lists facilitates good business in any respect.

So you do have some comfort from the chairman.

Mr Humphry—I have canvassed the matter with the chairman of the Australian Securities Commission. I have also talked to some of the chairmen of the leading institutional investors, who are the ones who have the greatest interest in this. They have also confirmed with me that their concern is with the judgment being exercised by

directors and not some form of form-filling exercise which is there to protect them.

CHAIR—Which is why I asked my question about the perception. In your opening statement to us, you talk about—and this was referring to derivatives, but I think it is a point that you would make generally—the protection afforded to participants and derivative markets and you say:

On the contrary, it is at the level of world-best practice, and I believe it is unmatched by any other market in Australia. We certainly have a well-deserved reputation around the world these days for our high regulatory standards.

In the corporate governance area the model, if you like, has been the London Stock Exchange with the Capri committee report which your discussion paper in September followed. I notice that recently in February the Toronto Stock Exchange, which has also been grappling with this issue, made a decision, and I quote from it:

"The new TSE Listing Requirement will make it mandatory for companies to disclose their corporate governance system making particular reference to the guidelines contained in the TSE Report on Corporate Governance . . . Where a company's government system differs from the Report's guidelines, it will be required to give an explanation of the differences.

So the perception problem is not that you have come down a peg, but the perception problem may well also be that in terms of international standards we are not quite up to the mark of London and Toronto. Do you see that as being a perception difficulty and, if you do, how do we get over that?

Mr Humphry—I do not personally see it as a difficulty, because I have had the necessary feedback from the institutional investors, who are the ones who are primarily interested in this particular area. Also, what we would achieve by going down this route is virtually a complete consensus amongst all of the participants in the market. In other words, instead of it being a coercive thing, we are seeing it as one in which people are wholeheartedly embracing. Through this mechanism, if it is handled correctly—and I think we should review the process in about a year—my own view is that we have a potential to have a far greater provision of information to the community based on more judgmental aspects than someone who is simply responding to a pre-set form.

I think it is a mistake to consider that so-called best practice in corporate governments is something which remains static because it does not. Over the next five to

10 years, there will be changes. If we fill this form out, as I guess would be the way in which the others must go, they will have to continually review those rules. It will be very difficult for them to get consensus on all of the ways in which companies need to respond. If you have a family company with three directors, and we say you must have a remuneration committee, how will they cope with that? They can set one up if we insist on it, but in a sense it is simply just a requirement to meet our requirements, not something which might allow them to consider an alternative and perhaps a better method of achieving the objective of either establishing levels of remuneration or appointing new directors to their board.

I think the mechanism we are providing offers scope for that, but we will need to monitor it to see the degree of compliance. I think you can draw some comfort from the fact that, if the investment managers association also provides a guide, then you really have it backed up twice. I hope that we would not go down the regulatory route on this proposal.

CHAIR—In the course of your comments, you referred to the responses that you received to your discussion paper. You said that 80 per cent supported corporate governments, which assumes that 20 per cent did not. I think you referred to 31 submissions which were against, although of those 31 the majority was in favour of disclosure. It was the degree of prescription that was of concern. Of the 31 companies that presented submissions, what type of companies were concerned about the degree of prescription? You made the point about putting onerous reporting burdens on the small family companies, but what type of companies have responded in this way?

Mr Humphry—We had submissions from nearly all of the major companies. It was in those particular areas where some concern was expressed. It all related to the issue of form over substance.

CHAIR—When you say major, do you mean the top 100?

Mr Humphry—I am talking about Coles-Myer, Pacific Dunlop, BHP—the large companies.

CHAIR—The top 10 and 20 companies rather than the top 100?

Mr Humphry—The top 20 companies, yes. We have spoken to those companies separately because we wanted to find out why they took the stance they did. Their principal concern was about the whole issue of a rigid form of a tick and flick approach; that is, form over substance. They said the best way to cope with it, in their opinion, would be to allow for some degree of judgment to be given. I found that I have backing for that from the chairmen of some of the very large institutional investment organisations. What I was seeking to do was to reach a point at which all of the parties were comfortable with what we were doing and where they would participate in it in a meaningful way, not be dragged into the process of having to do what they were told—which some of them had legitimate reasons for querying.

I am confident that the way we are going will not put Australia in a position of disadvantage from other countries. We are requiring disclosure. In relation to Toronto, it is almost precisely the same except for the final bit, which is to give an explanation of the differences. In other words, in the case of Toronto, they are setting up a series of items and saying that you must explain why you are not pursuing them. It does not mean because a company is not pursuing an option the company is wrong.

Mr SINCLAIR—Just on this question of criteria, the one area that seems to me to be missing in the corporate governance area—and it is obviously going to become more significant as more companies invest to a greater degree overseas—is that there is no real identification of the degree to which, as I understand in the procedures that are set down, the balance of a company's assets are located within domestic jurisdiction or outside jurisdiction. Have you thought of that, and do you consider it relevant? To my mind, that has been part of the trouble with the Barings instance. That is why I raise it.

Mr Humphry—We have not reached the stage of having to identify individual assets. It may turn out to be a fairly difficult process with very large companies because they have such large holdings. It would be possible perhaps to indicate the percentages of where they are located. It is worth pointing out that most of our large companies now probably have more operations off-shore than on.

Mr SINCLAIR—That is really why I raised the question. It would have to be on a

percentage basis, but the degree to which they are outside jurisdiction raises factors which have not previously been a domestic concern. I do not know whether that is a matter which you have given any attention to.

Mr Humphry—In my view, as long as they are subjected to either international or Australian accounting standards for financial reporting, whether the assets are off-shore or not, the methodology that they apply will be those which we require for purposes of governance of the exchanges operations. BHP is still required to meet continuous disclosure requirements—whether it is of assets—wherever it may be in the world. So if a significant issue arises, BHP must make it available to the public.

Mr SINCLAIR—BHP is seen as essentially an Australian company, but more and more companies are being listed on more than one exchange. Presumably, the corporate governance's obligations of other exchanges will require BHP to report in those markets where it is listed as it would in the Australian Stock Exchange. If you do not identify the degree to which companies are doing more business outside Australia, you could find that the shareholders could be more exposed. I do not want to make too much of it, but it seems to me that, from reading or hearing things, that is an area you have not identified.

Mr Humphry—I think the point that we should make is that any company which is listed on the Australian Stock Exchange—whether it be an Australian home company or foreign based—is required under listing rule 301 to provide continuous disclosure. So it must do that. It cannot avoid providing information to the home market. I might ask Mr White to elaborate on the concept of the home exchange concept under FIBV.

Mr White—When a company is listed on other exchanges, there is a requirement for the notification to go from the home exchange. If an announcement is necessary out of hours of the Australian exchange, it can be announced on the foreign exchange but has to be immediately faxed to our market so that it can be divulged immediately our market starts to trade. There is a regime with the International Bourse Association where we consider which country is the home exchange for a company. That is so we can make sure there is a level playing field of understanding between exchanges as to who has the lead regulatory role.

Mr SINCLAIR—In that reporting, is there any obligation on the degree of exposure of a company?

Mr White—At the moment there is no degree of exposure. A company will have its home exchange in its jurisdiction. For example, News Corporation is an Australian-listed company. Its level of assets around the world is measured through the accounting and disclosure processes through our exchange. We are the lead regulatory exchange for News Limited.

Mr SINCLAIR—Without pursuing the matter, there seems to me to be a problem with trying to ensure that for a company which enjoys multiple listings there is the same degree of information available within the Australian Stock Exchange. Do you feel that the reporting obligation that you have just identified is sufficient to reasonably satisfy investors?

Mr White—Yes.

Mr Humphry—The point we are making is that we would require from a foreign company no less information than that which we would require from an Australian company. We think that is adequate for the purposes of decision making by investors at the moment.

CHAIR—If I can just pursue a couple more questions on corporate governance. In your discussion paper, you listed a range of measures which you were seeking views on as to whether they should be included as corporate governance issues in respect of which listed companies ought to report. You have referred this morning to eight items that you will include in your indicative list. Which ones from the ones you put in your discussion paper have dropped off to be part of the indicative list?

Mr Humphry—I have not yet provided a list to the committee, and I have not got a copy of the original list with me. We believe that all of the essential matters that were listed in there were picked up. All of those matters which revolve around the question of balance between executive and non-executive directors and the mechanisms for setting remuneration have been included in our list. We submitted this process to our national listing committee which spent a whole day going through the process. We believe that we

have captured those areas that we believe are relevant for disclosure for corporate governance practices.

CHAIR—From the eight you read out, you have got the ones that people would generally put in their basket of the key corporate governance issues. In your discussion paper of December, there is reference to the adoption of a written code of ethics. Is this one that has fallen off the list?

Mr Humphry—No, I will just refer back to that. Item 8 is the company's policy on the establishment and maintenance of appropriate ethical standards.

CHAIR—Yes.

Mr Humphry—I actually think we have picked them up. We wanted to keep this as a schedule, so that as time passed we could extend it with other matters that might be brought to our attention.

CHAIR—You referred to speaking with the AIMA—the Australian Investment Managers Association. Was that on this proposal and, if so, what is its attitude to this proposed listing rule?

Mr Humphry—I think the AIMA acknowledges the difficulties of coming up with a prescriptive phase. It is generally supportive of what we have done, but I think it wished to complement it with what it would see as its perception of minimum requirements that people must conform to. So what we may be requiring disclosure through the listing rules is what it may be setting as criteria for institutional investors when placing their portfolios.

CHAIR—In the *Australian* on Thursday 23 February, Mr Westfield appropriately referred to these issues under his comment piece 'Insider'. He said, 'ASX will steer a middle course on board behaviour.' He is basically predicting the sort of listing rule that you have outlined today. So he is doing well inside somewhere. He refers to:

> It will fall short of the high ground expectations of groups such as the Australian Investment Managers Association and the Australian Institute of Superannuation Trustees.

He then goes on to say:

> You will upset the directors group who want self-regulation and a hands-off approach from the exchange. So it may well be that if you end up pleasing no-one, you have actually made the right decision.

From what you are saying today, the reported position of the AIMA would not be its

current position?

Mr Humphry—I have discussed it with various members of the investment association, and I do not have a common approach coming back to me. From senior members and chairmen of various groups, I have got strong feelings that we should not be too prescriptive because of the issue of judgment being able to come through. From some other quarters, there is some interest in being more prescriptive. I think the only way to resolve that would be to discuss it with the AIMA and to see what policy it has finally agreed on. I can assure you that there are certainly significant elements of AIMA that would be quite happy with this approach.

CHAIR—Mr Westfield's article also says, 'ASX insiders acknowledged that the Cadbury approach is running into trouble in the UK.' Do you wish to comment on that?

Mr Humphry—That is his comment. I would not have gone as strongly as that. The difficulty is that we can start a lot of these things up as an interesting development at the time, but to maintain them requires setting up a committee which then has the impossible job of obtaining some form of consensus across the whole variety of corporations. They are not going to be able to do that, and even this exercise has brought that issue out. What I think is essential is that we provide a climate in which we can encourage people to come through with their innovative approaches to corporate governance. I believe that the way to do that is by being less prescriptive.

To the extent that I would have reservations about the models that were set up in London, and the one which the Toronto Stock Exchange is pursuing, it is only in that I think that they may be locking themselves in, unnecessarily so. The key is going to be whether companies respond fully to their corporate governance practices. The best way I can assure the committee that that will happen is to say that the ASX will take a keen interest in it and will review the process in about a year. Then we will be in a position to evaluate that fact at that time.

CHAIR—What format or approach will your review take?

Mr Humphry—We would probably do it by way of examination of annual reports, to see what practices they would follow. It would probably involve some form of

interviewing of a range of companies, so we will be able to test. We would be happy to bring that material to this committee.

Mr SINCLAIR—In relation to this annual review, is it envisaged that you would refer to, for example, what has happened in London, Toronto and in other exchanges to see how they are moving in corporate governance? Or do you more or less intend to proceed in isolation?

Mr Humphry—We continually monitor what is taking place. We meet annually with a body called the FIBV, which is an international body. So we have opportunities to exchange information. We also receive updates from time to time on the developments in those countries. In this case, we have tried to build on the experiences of elsewhere and then use them to come out with what we believe is the best product. I must stress that what I am giving you is my recommendation to the board, not the board's decision.

Mr SINCLAIR—I was really getting at how you are going to be able to measure the success of your corporate governance against others. Are you going to relate it to companies that have failed? Are you going to do it by relating it to the extent to which you feel shareholders have been disadvantaged by factors relating to takeovers of companies that have not been disclosed? You made some criticism of the London and Toronto forms. That is why I am trying to find out to what degree is some criteria going to be used in the measurement of your corporate governance.

Mr Humphry—If I were confident that there was a measurement mechanism that I could use to see whether the LSE or the TSE have been successful, I would use that. We will try to assess the degree of success, or otherwise. I think that one of the more important assessments we can make is whether companies have disclosed all their corporate governance practices; that is, are they open and transparent with what they are doing? My personal view is that they have every incentive to do that, since it will attract investor confidence. I would then need to measure that against the types of disclosures that are occurring under these more regulated environments to see whether or not the information matches. If it does not, then we will have to analyse the differences as to why.

CHAIR—Our formal response, or report, on corporate governance is part of our current public inquiry into institutional investors. Your information to us today, and the decision that the board makes tomorrow, will be very helpful in that respect. You should not take my questioning too sensitively. I accept that, in the end, this is a matter of trying to ensure effective disclosure by substance rather than form. I am pleased to hear that, whatever model you adopt, you are proposing to keep that under review and to see where you come up. However, I am concerned that we will have this perceptional problem that we might fall short of a previous expectation and fall short of what is regarded as international standard. In the end, we hope that we get it right.

Mr SINCLAIR—I have a question relating to international registration. There has been discussion about an Asian board. To what degree are you going to require Asian companies that you seek to have registered on your ASX pursue the same corporate governance as is required in Australia.

Mr Humphry—Any company which lists on the Australian Stock Exchange is required to maintain the same levels of disclosure that we require of Australian companies. That is an absolute. We will not allow their listing to occur in the first instance. We already have six companies, China concept companies, listed on the Australian Stock Exchange. They have been required to conform to prospectus and disclosure rules and to financial reporting. So they would be subjected to the same requirements.

Mr SINCLAIR—So, if there were to be an Asian listing, as has been suggested, the same obligations would apply as to any on the general list.

Mr Humphry—Yes. The jurisdiction that we employ in Australia would apply to any company listed. We may group them for purposes of indexes—say, an Asian index or a Pan-Asian index—but that grouping is there for the information of investors. It is still underpinning them for the same amount of regulatory and supervisory activities that applies to all companies listed on our exchange. I want to make the point that what we are proposing here will require disclosure of corporate governance practices. We are really talking on the margin about whether or not they explain why they do not comply with some of these so-called practice statements. We are not allowing people not to report on

what they are actually doing.

Mr SINCLAIR—The obligations will be to report but not necessarily to comply, will they not? Take some of those obligations for disclosure with respect to directors. They are hardly going to respond, because of their different cultures and different societal practices, in the same sense that you would expect an Australian company to respond.

Mr Humphry—If there is full disclosure, then I expect the investing community to respond accordingly. It is all about risk, is it not? We are saying that if a company gives full disclosure and provides information which satisfies investors, then presumably it would receive some benefit from that. Therefore, I think there is every incentive for companies to properly conform to this listing rule.

CHAIR—Good luck at the board meeting tomorrow. I will move on to derivatives and the post-Barings situation. It would be remiss of me not to ask you the same question that I asked the Sydney Futures Exchange. So far as your derivatives trading is concerned, can you guarantee that the Barings situation will not occur in Australia?

Mr Humphry—I can provide an assurance to the committee that, so far as systemic risk is concerned, we believe that we have more than adequate procedures in place to give comfort on that score. I do not believe that any system—regulatory or business rules—can ever legislate against fraud or non-compliance with rules. That is a matter for checks and balances. I remind the committee that, when I was Auditor-General of Victoria, I was always taken by the fact that we did not discover one fraud by means of systematic checks. We discovered a lot of fraud, but that was brought about by some of our auditors looking under pieces of corrugated iron or people frankly dobbing other people in. I think it is important to keep in perspective that you can legislate for good systems, but you cannot guarantee—and therefore I cannot guarantee to you—that fraud could not happen. But it would require a breakdown of systems for that to occur.

CHAIR—Have you conducted a review of your system, post-Barings?

Mr Humphry—We have. Perhaps it might be useful at this point for Mr White to address the committee. He was informing me that, periodically, we carry out stress tests, as he describes it. Effectively, this is simulating the 1987 crash. He takes the current

position of the market at a particular point in time, simulates what would happen if 1987 occurred and sees how those organisations would be placed. In addition to that, it is backed by continuous monitoring. We have annual audit checks of all of our broking houses, which is carried out by our membership division. There is continuous surveillance going on. Perhaps Mr White could elaborate on his stress test.

Mr White—We have a process of risk management within the exchange. We use a system called TIMS, a theoretical and inter-margining system. It is used by a number of other exchanges around the world. It was developed by the Option Clearing Corporation in the US. Currently, it is used by the Chicago Board of Options Exchange, the New York Stock Exchange, NASDAQ, the European Options Exchange and us.

Our systems require us to account to a client level rather than just to the broker level. We provide all the accounting processes for our member organisations so that they are able to have their position statements of each individual client. We are the only exchange in Australia and, as my inquiry shows so far, the only one in the world that accounts down to a client level. This enables us to make sure that the risks within the member organisation are not netted off against each other. We can see the gross risks at a client level rather than at the overall broker level. I receive a number of reports on my desk each day showing the largest positions of any of our member organisations, and if any situations look untoward then we will contact the member organisations and require them to either increase the amount of funding that they have into our clearing house, close out positions or move positions from their organisations to a member organisation which may have better capital backing to support their client.

We can tell at an instant, the level of risk of any particular client, we can tell clients across the different brokers so that if a client was to go to three different brokers, and if one broker did not realise that he was trading with another client, we would consolidate those positions. As a final test on a regular basis we look at what would happen if we had a major movement in the markets to see the impact on the clients themselves, the member organisations and on our clearing house, as to our funding position.

Mr Humphry—There are a number of initiatives that we have taken. We have mentioned in the opening statement that we have written to the Australian Securities Commission suggesting that we set up a derivatives consultative group. We have carried out an analysis of the information that we have to date on the Barings collapse and the issues that are arising from it, to see if we can identify those issues and then test them against our own operations. We have also looked at internal flows of information to see that they are adequate. Now in that process we have discovered some things that we think we can improve on, like we expected to. You always do find areas you can improve on, but there has been no major concern that we have been able to detect. So we are fairly confident that our systems would stand up to a particular situation like that. The point that David White is making is that these periodic tests on a potential crash—and they have been going on for some time—give us a lot of comfort that we would have sufficient knowledge and be able to react to an emerging situation.

CHAIR—Have you had a response from the ASC on your proposed derivatives consulting group?

Mr Humphry—Not to my knowledge as yet, but I would think that that would come. We hold periodic meetings with the Australian Securities Commission and the issue came up in discussion; this would have been about a couple of weeks ago—15 March. We wrote off to them and we would be confident that they would support the move.

CHAIR—We might try to get a response for you on Wednesday.

Mr SINCLAIR—When they saw us a couple of weeks ago they were talking about a meeting in Florida where they were going to talk about a few of these things.

Mr Humphry—Yes. The Sydney Futures Exchange was talking about that. A futures conference is to be held in Florida—I think that has been held.

Mr SINCLAIR—Yes, it was last Friday. You were not involved?

Mr Humphry—We do not maintain a futures market, Mr Sinclair, but there is an options group. Again, it is a parallel group and perhaps Mr White can elaborate on that, but we would be participating in that in that forum.

Mr White—There is an international Options Market Association which is meeting

in June, and obviously the question of Barings and the lessons from Barings will be on the agenda there. The futures association meeting that was being held in March in Florida is an annual event that is held by the Managed Futures Association in the US. There were a number of speakers from the Commodity Trading Futures Commission and the SEC at that conference, and it was raised that there may be an international committee put together to discuss the outcomes from Barings. We have written to the chairman of the Commodity Trading Futures Commission in the US, Ms Shapiro, and suggested that the ASX would like to participate in that committee process. So we are keeping a watching brief and keeping in touch with the international regulators to see how we can participate.

Mr SINCLAIR—Thank you.

CHAIR—One of the issues that we put to the SFE was the extent to which they conduct cross checks with international counterparts. In your own derivatives trading, to what extent is that either required or necessary?

Mr Humphry—I think in our case it is principally a home market. I will ask Mr White to discuss it in detail, but I think it is an important issue because we are starting to see an internationalisation of our markets. There is going to be a major difficulty ahead in maintaining appropriate contact on cross border flows. I do not think anybody in the world would have a solution to that at the moment. How one would go about corralling all of the exchanges—and there are literally hundreds of them—I think would be a daunting task. But what would be required before information flow would be some form of standardisation of disclosure across different countries. That is something which I would hope that the Australian Securities Commission would be raising through IOSCO, which is the body for international securities regulation. Perhaps you could elaborate, David.

Mr White—Certainly. The issue in relation to Barings was that there was a common contract traded between Osaka and Simex, and there it would seem that there was not the close discussion between the two markets as to the growing positions on either of the markets. There is a requirement for us here in Australia where we have a memorandum of understanding between ourselves and the Sydney Futures Exchange, where there is a linked product or process. For example, they trade a share price index

contract and we trade individual shares or the option contracts over those shares. We share information.

At an international level, if we wanted to list our Australian products on an American exchange, before we could do that we would have to enter into an agreement with the International Surveillance Group, which is set up between regulators, to make sure that there is a sharing of information. I do not believe that such an arrangement was between Osaka and Simex on their particular contract. Certainly we would not enter into a product on another market where we did not have the proper surveillance arrangements in place through a memorandum of understanding with the linked exchange.

I do think that in the future there are going to be more products that are traded on a 24 hour style basis around the world, and it will be necessary for there to be arrangements in place, memorandums of understanding, between the exchanges where those products are traded.

CHAIR—With your own trading, have you ever had cause to hear alarm bells ring and to speak to institutions concerned?

Mr White—On our own particular market?

CHAIR—Yes.

Mr White—We have had situations, not of the magnitude of a Baring's style situation, where we have picked up clients trading between different member organisations, which has led us to contact those organisations to rationalise the positions and to make sure that there was proper capital in place. We have, at times, called additional capital from our member organisations to support the positions that their clients are carrying.

CHAIR—So what formal procedures do you follow when you engage in that sort of activity?

Mr White—It is really a matter of discussions, talking to the managing directors of the particular member organisations. You have to follow these issues on a daily basis. I receive a report of the positions on my desk each day, and, if you start to see positions arising that may look out of size to the size of the capital of the member organisation, you

get on the phone. I think that is one of the most effective ways of actually monitoring the market.

CHAIR—The Companies and Securities Advisory Committee has currently got under way a study on derivatives, and we are speaking to that committee on Thursday. Have you been involved in that process?

Mr Humphry—Yes, we have made submissions to the CASAC group. In fact, we have made submissions on all of the 10 papers or issues that it has addressed, but we have made a special submission on derivatives to the derivatives sub- group. Again, David White was directly involved in that and has had discussions with the CASAC group, which I am sure he would like to elaborate on?

Mr White—The derivatives council that CASAC has set up has two members on the panel—myself and David Shortland. We have prepared a paper for the panel, which we delivered at its last meeting in February, which outlined where we believe the legislation should go in relation to derivatives. It outlined how we should try to answer this question of a separate chapter 7 and chapter 8 and how it should be formed in the future. The paper was much along similar lines to the ASC's own paper on over-the-counter derivatives, inasmuch as it looked at three tiers of regulation. The paper has been well received by the committee and is currently under debate.

Mr Humphry—One matter the committee might be interested in is that the whole wash-out of the Barings issue is not yet clear to any of us because we are still waiting on the Bank of England report. When that report is available, it will provide an opportunity for a greater analysis. I would be happy to forward the report, when we obtain it, through ASX, or you may wish to seek it directly yourselves. The other matter I thought you should be aware of is that the group of 30 have made, I think, 24 recommendations in relation to the operation of derivatives, which I think also has a bearing on a future deliberation of this market.

CHAIR—We would, of course, be interested in the results of the review of your own arrangements, and we can no doubt take that up in the usual way.

Senator NEAL—I just have one question on that area. There is some suggestion

that the major reason for the difficulties with Barings involved failure to disclose the risk within the accounts of the company. Do you have any comment on that, and do you have any suggestions about how the accounting code should be altered to more accurately disclose that risk?

Mr Humphry—I am sure that Mr White will be able to enlighten you, but the fact is that we would not have that problem because our disclosures are such that it would require that information—it would be picked up. In other words, what happened there, I am confident, would not occur in Australia at the moment.

Mr White—I think there are two aspects to your question. The first part is that within the actual accounts of Barings we have not, as yet, seen the final audited accounts of Barings as at the end of December 1994. The last published accounts for Barings were at December 1993. Within those accounts, it did disclose its level of principal positions and the level of off balance sheet derivative trading that it had. It would seem within the Barings situation that there was a deal of activity that occurred towards the end of 1994, particularly in early 1995, that led to the position that it was in. So we have not as yet seen the final wash-up of the accounting process.

The accounting profession currently has exposure draft 59 out as a paper on disclosure. There have been some quite good improvements in disclosure and accounts, particularly by our own banks here in Australia, as to the level of derivatives disclosure. I think that is a question that will receive further debate within the accounting industry.

The second part of your question most probably relates to the disclosure of the positions within the clearing house and just knowing exactly where the risks were. Again, in relation to Barings, the Simex exchange had actually received all the deposits and margins that it had acquired from Barings. It had paid up the $1.3 million, and that money was available in the clearing house to satisfy the margins and deposits that were necessary at the time that Barings collapsed. From that viewpoint the system, in a way, worked. The shareholders lost their money, but the participants in the market were actually paid out because the money had been properly delivered to the clearing house and the clearing house was able to settle the contracts when Barings went under.

So within our own system here we have adequate knowledge of the positions that our members and their clients have. We make sure that those deposits and margins are paid each day into the clearing house. If we require extra money, we levy that extra money against the client or the member organisation to make sure the funds are in place.

Mr SINCLAIR—Could I just follow on? One of the problems appears to be that as a result of a new type of tradeable instruments, as with bulk bonds and now with a range of other derivatives, every time you develop a new type of a tradeable instrument there is speculation about what it means and how it can adequately be traded in without exposing undue risk. Obviously the Barings instance highlights a particular instance as did each of those former people who went under in the United States with different types of instruments that have been debunked.

It is not the last one that worries me; it is the next one. I wonder to what degree you have put into place some sort of a mechanism, which seems to me to be not peculiarly your responsibility but demonstrably it is either you or the SFE that is likely to be involved in them, and presumably with the ASC, to ensure that for any new tradeable instrument there is some set of ground rules that would apply to minimise exposure. You are really looking at corporate governance and to the people who are your clients as well as the dealers. You have applied restrictions. Do you feel that they are sufficient, on the one hand, to protect the marketplace investors and, on the other hand, not to unduly inhibit the development of new instruments which seem in many instances to in fact help the expansion of capital markets and consequently be beneficial? It is that that seems to me to be the hidden question behind the lessons from Barings.

Mr Humphry—The short answer to your question is, yes, we are satisfied. We cannot introduce a new security without having to go through the Australian Securities Commission and agree on a set of rules, and they and ourselves are really quite stringent in that process. The product of share ratios, which maybe we will come to at a later stage, is an example of that. There has been a whole series of meetings over, it must be now a year, well over a year, in working through and ensuring that there is adequate protection in the system and proper disclosure and reporting. So I do not think that you need have

any concerns about the process which is followed here. It is stringent by any standards.

The other matter that you have raised, though, is something that I would like to emphasise, and that is that the principal function of the exchange and, for that matter, the SFE is to increase its share of market, that is, to grow and thereby contribute to the Australian economy. I do not think that our function is principally there to concern ourselves with just having more and more regulation. But we are, of course, in constant communication with the ASC, the Attorney-General's Department and the Trade Practices Commission who have the principal responsibilities in this area.

CHAIR—I might just move on from post-Barings to the general chapter 7 and chapter 8 issues which really give rise to whether you should be trading in derivatives at all, your relations with the SFE, the Federal Court decision or case that you have been embroiled in for some time, and the bill currently before the House. In your opening statement you make the point about chapter 7 and chapter 8. You make a comment along the lines of one that I have made previously which is why are we hung up on the fine distinctions between 7 and 8 when, surely, what we should be doing is just making sure you have the necessary investor protections, underpinning regulations and corporations law, and let people go off and trade in whatever they like.

But when we spoke to the SFE a few weeks ago there were a couple of things that the SFE had to say which I would like to formally put to you to get a formal response to, some of which are taken up in brief in your opening statement. Mr Hoskings said, in the course of his evidence:

> We are very strongly of the view that the chapter 8 Corporations Law provisions for the regulating of the derivatives market in Australia, in particular, exchange rate of derivatives markets, was designed to manage the risks that arise in these high-risk instruments like futures. It was designed in the mid-1980s with a view to ensure that there was proper oversight to the volatile and high-risk futures market. There was a conscious decision back in the mid-1980s not to use chapter 7 because it was inadequate for derivatives trading, for futures trading. It was a conscious decision.

He went on to say:

> Our concern still is that they are basically voluntary rules. They are not embedded under chapter 8. Frankly, they are rules that are yet to be tested through the 1987 crash and the bond market reversal. The history of the Sydney Futures Exchange rules have been tested and their measurements have been tested. The anomaly to us is that it

seems to be a backward step in the prudential regulation of derivatives to water down chapter 8 now and allow other people to trade.

Mr Humphry—You will not be surprised to find that I totally disagree with those comments. I actually think most of the statements in there are complete nonsense. Chapter 7 was developed at a point at which at that stage it was mainly dealing with the equities market, and then it was modified and added to to handle the introduction of options. Chapter 8 was specifically designed for futures, and one needs to distinguish between futures markets as derivatives and other forms of derivatives.

But whether it is chapter 7 or 8, Australia operates under a two-tier system. We have the corporate law under these chapters, and they are backed by business rules. You have to look at the two as the two tiers which are together. Now our business rules are not voluntary codes; they are not only in the form of a formal contract between the broker and the exchange but they are backed by two sections of the Corporations Law, 777 and 1114. Those particular sections enforce the business rules. So what we have is a combination which works together.

I could equally point out to you that if you were to go through the schedule that we have provided that there are a number of areas where chapter 8 is deficient. We can go around and play this game if we wish. For example, under licensing provisions, chapter 8 does not provide for future licensees and, under civil liability for breach of licensing provisions, there is no civil liability under chapter 8 on persons who merely hold themselves out as carrying on a futures broking business whereas it does apply under chapter 7. And perhaps the most important one is under the 'Know your client provisions' under chapter 7. There are extensive investor protection provisions requiring security dealers to disclose commissions, be aware of their client's individual investment objectives and to have a reasonable basis for making a securities recommendation to the client. There are no equivalent provisions under chapter 8. In respect of futures, it is up to the client to satisfy itself whether the contract is in the client's interest.

I think the point that I am trying to make is that it really is nonsense to say that one is superior to the other. There are many instances where there are deficiencies, technical or otherwise, in these pieces of legislation. What has happened is that they have

been backed up by business rules which are really given the force of law. My concern that I would put to you is that it is a pity that we have got two chapters. If we had one single chapter of a more generic nature and if we were to support it with various regulatory structures we could then handle, I think, the development of new product ranges in a much more flexible manner and yet give protection and still have parliamentary oversight of the process. Now this particular document was put together by Karen Byrne. Is there anything you would care to add, Karen?

Ms Byrne—No. I think it is important to emphasise that the distinction between the two chapters arose out of an historical accident, basically. We started off with two industries which were quite distinct and separate but, if one looks at how those industries have developed, we have had an abandonment of the primary production relationship between futures contracts; we have had a development of new derivative products by both exchanges, and we have had an increasing use of cash settlement as the method of settlement for products. That means there are substantial areas of both markets which have become very similar, and that in our view has led to a need for uniformity and some rationalisation of both chapters.

Mr Humphry—Now where we went through the process of the low exercise price options, which is an option that is deeper than money and relates back to the equities base, then argument broke out as to whether it should be ruled by chapter 7 or 8. We have been to the courts. Both the original court hearing and the final judgment of appeal supported the view that chapter 7 was the appropriate place for the supervision of that particular product.

Again, with share ratios we have developed a series of rules which have been worked up in conjunction with the Australian Securities Commission to ensure that we can trade effectively through chapter 7. If at some stage in the future, and it is likely, that the Australian Stock Exchange launched a futures market, which we will do, then of course we would be governed by chapter 8.

Mr TANNER—I do not have this before me, so this may be a question that is a bit out of line. In your contrast between chapter 7 and chapter 8 you referred to the

differing situation with respect to civil liability. I would have thought there would be civil liability of common law with respect to people operating under chapter 8 anyway. Is there any substantive difference between the two, even though one is codified and one is not?

Mr Humphry—The point I was trying to make is that there is no substantive difference between the degree of protection that either chapter 7 or chapter 8 provides. They are two-tiered and backed by other rules that mean they actually work together. The fact that they are different is an historical process and nothing more than that. While it is not designed to allow an easier regime to function, it simply does not apply that way. The more important issue that we need to make to the committee—and I am sure the committee appreciates this—is that we cannot keep on adding different chapters every time we have a new product without creating enormous confusion. It is far better if we rationalise the process. My understanding is that ASX is addressing itself to this issue now.

Mr TANNER—The same logic applies to the future of the two bodies, presumably, on whether they can continue to operate.

Mr Humphry—My personal view is that we benefit from competition. That is the point: we are in a competitive position with the Sydney Futures Exchange and the derivatives area. It seems rather strange to me that the Sydney Futures Exchange sees its role as regulating us when, in fact, we are two competitors.

Mr TANNER—So does that complicate the possibility then of listing shares?

Mr Humphry—SFE would have to if it decided to go that route. There is no restriction in Australia to anybody establishing a stock exchange. It is just a matter for anybody to set up. We are not an actual monopoly that is protected in any way by law.

CHAIR—I would not want to put a question based on an obvious difference between you and the SFE without also putting some common ground that you have with them. I put the same point to Mr Hosking when I asked why we have these constant demarcation disputes over 7 and 8 when one regime would be preferable. He responded:

> We do not have a problem with that—we never had. The only argument has been as to what the regulatory mechanisms were that were to be used.

So the SFE may think there is a better regulatory regime which would enable it to trade in

whatever it wanted and you to trade in whatever you wanted. I will just refresh my memory from our previous hearing with Mr Cameron from the ASC. He did not quite say that expressly, but I think he might say it expressly on Wednesday if he is asked. What do you see as the best vehicle for achieving this end result so that we do not have the Federal Court cases—such as LEPOS—every time there is a new product developed, and we do not have to rush off to the parliament by way of legislation or regulations to find a hybrid model?

Mr Humphry—The process that is already under way through CASAC is the way it should progress. I just do not think we should allow grass to grow under our feet. I think it is a matter which requires fairly urgent attention, so I would be looking for a solution earlier rather than later. As I understand it, the matters are progressing, and I am sure the committee will have a chance to evaluate that when it meets with CASAC.

It is quite true what you say: the relationship between the SFE and the ASX is actually quite cordial on non-competitive matters. We meet regularly in a number of forums. We are jointly dealing with an issue at the moment in relation to the importance of raising awareness of capital markets, both in our political scene and in our community. We feel that there is insufficient understanding of the importance of capital formation for growth in the economy. We are also looking at the issues of impediments, costs of transactions and stamp duty particularly. We are working jointly in that area.

CHAIR—Having found a common ground, let me now find some uncommon ground. The question of the ASX trading with derivatives goes to the national guarantee fund and the suggestion Mr Hosking made on the last occasion he was before us when he said:

> We have expressed our concerns about exposing derivatives markets to the national guarantee fund and we are not convinced that that is appropriate. . .

Do you see the provisions that you have, with the backing of the national guarantee fund, being appropriate for trading in derivatives?

Mr Humphry—I do. I think this is a system which in the past has worked well with the equities markets. I think it is quite appropriate to continue with in the future. But they are a backstop; they are not intended to be the front line.

Ms Byrne—SEGC is the board entrusted with the responsibility for administering the fund. I think the comments Mr Hoskings made were in the context of share ratio contracts. SEGC commissioned Tillinghast and Towers Perrin to review the risk profile of share ratio contracts with the fund to see whether they posed a substantive risk and would undermine the fund. The report concluded that, based on the information provided:

It was not expected the introduction of share ratio contracts would lead to a serious undermining of the financial resources of the fund.

They were quite confident that this new product did not pose a problem for the fund.

CHAIR—What is your current view of how the continuous disclosure regime is working?

Mr Humphry—We are actually very pleased with its progress. We sought some advice on this because we have now had in place, as you would be aware, a requirement under rule 3A(1) for continuous disclosure to apply for some months. We believe that the ASX is in a better position than the Australian Securities Commission to respond to market disclosure matters because of its fundamental responsibility to conduct an informed market and because of a sophisticated surveillance capability and because of its ability to look beyond the mere words of its listing rules to the spirit of those rules. The exchange is confident that the vast majority of companies are taking their disclosure obligations seriously, as they have always done, and so far we have had only one referral to the ASC under section 7762A in relation to listing rule 3A(1).

One of the developments that the committee may be interested in is that we were approached by one of the large corporations in Victoria and asked whether we might conduct some seminars on continuous disclosure. We have done that and we intend to extend that to other states. We found that to be very well received by company secretaries. But the pleasing thing is that they took the initiative in trying to seek to see that they were satisfying the spirit, as well as the letter of the law. I think both the corporate sector and the exchange are taking the matter seriously and it does appear to be working correctly.

The other point is the relationship between the ASX and the ASC in respect of continuous disclosure. I suppose it would be fair for me to say that if anything that interaction between the two bodies is increasing in our efforts to regulate the securities

market. The ASX and ASC have agreed areas of service provision so we do not overlap and regulation covering ASX's members, listed companies and the markets are all dealt with. We have now got memorandums of understanding in place for all of those.

At the operational level, we have got regular meetings being held between the ASC and ASX representatives in all states and on a more informal level daily where there is frequent interaction. There is a joint ASX, ASC, DPP conference—it was held in April—on efforts to maximise the market effect of regulatory effort. Yesterday, I was at a conference of the Australian Securities Commission in Terrigal addressing it on the issues relating to the exchange. So we have a continual interaction taking place.

The other matter that I might draw to the committee's attention is that nearly one-quarter of the Australian Stock Exchange's expenditure is now devoted to other surveillance or to supervision of both the corporate sector and the brokers. What we have is a truly complementary system operating between the ASX and the ASC.

CHAIR—How are you going with the implementation of the CHESS system?

Mr Humphry—The CHESS project is working well. You would be aware that when this system first came into being, like any new development, there was some concern by people who were wedded to holding a little bit of paper saying that they held a share. There was some reluctance to hand it over to an electronic record.

Mr SINCLAIR—It is a bit like pre-selection really; you need a piece of paper.

Mr Humphry—Yes. There may be a parallel. I thought a more appropriate parallel might have been the introduction of the automatic teller machines in banks, perhaps, but that example would work well. I think that that is now beginning to disappear. We have about 40 per cent of our companies now fully on the CHESS system and we would hope by October to have the other 60 per cent up. There are some 200,000 individual holdings now on the CHESS central subregister, spread across some 56,000 holders, and we are going to exceed our original systems design projections of a total of 300 holdings in 100,000 holders in the subregister. But there is no doubt that the system is working successfully.

You would be aware that recently the ASX existing settlement system was awarded

No. 2 place in the world, only behind the United States. I am confident the once CHESS is operational we will be able to challenge for the No. 1 world spot. In October we intend moving to phase two, and that will include full delivery versus payment system coming into force. At that point we will have a totally automated settlement system in operation.

CHAIR—My final question is one I should have asked you earlier under the chapter 7-chapter 8 heading. The futures and securities amendment bill is currently before the House. you would not see any reason to hold that up pending post-Barings analysis?

Mr Humphry—No, I would not. The bill has really, in my view, nothing to do with Barings; it is about the introduction of a new product specifically designed to further in my opinion Australia's interests. There is a great deal of interest in this product overseas and I am worried that someone else will take the initiative. It was, after all, an Australian invention by a Victorian broker and it is an important development as I see it for the country. I spent 30 years in the public sector before I came to this job and I can assure you from my background that many of the issues that we are facing at the ASX have equal importance to public policy and national interest, and I believe this is one of them. So I hope that the parliament will agree to its passage as the Senate has already done and then we can get on with the business of introducing the product.

Mr SINCLAIR—Is that proposal the same as with the corporate laws through the simplification? Have you any views on where it is going and the reaction to it?

Mr Humphry—We are actually very pleased with that process. We have now produced I think 10 papers, from memory. I will just refer to my notes. Yes; the Corporations Law simplification since March 1994 has now produced 10 exposures and discussion papers. We have responded to all of them with the exception of small business. We have dealt with share buy-backs, company registers, annual returns and financial reporting, defunct companies, accounts and audit, share capital rules, company names, forming a company and company meetings. With all of those I could provide individual comment, but the broad view that we have is that we are fully supportive of the direction that it is taking.

My only concern will be that we do not wind up with more law. I think it is an

important point to make that there have been so many changes to this law, and we have coupled this with other laws. It is becoming a bit of a burden now on the business world to be able to cope with it all. Keeping up with it is a major exercise, so we hope through the simplification process, which we do support, that what we will have is a truly simpler Corporations Law and not simply an extended one with more words in it.

Mr SINCLAIR—I must admit that one of my concerns is that it needs to be all consolidated at the end so that you can all have the law in one place and not a series of bills which makes it extraordinarily difficult to comprehend.

Mr Humphry—Yes. I must say that I am not a lawyer, and I am sometimes accused by my colleagues of perhaps having strong views about it, so perhaps I should ask Karen Byrne to give a professional view on the simplification process.

Ms Byrne—A number of the discussion papers have related to the concept of simplifying the law to facilitate small business. In that respect ASX has not been a key stakeholder in the process. But, having said that, we have taken an active interest in all of the discussion papers that have been produced and I think we are very happy with the level of consultation and feedback that is involved in the process. I think the task force is to be congratulated because I think it has done a lot of work in a small period of time and still in the process has been able to adequately and fully consult with those interested in that process.

Mr Humphry—One thing we can add is that, in parallel with this, we in the exchange have embarked on simplifying the listing rules. Hopefully, one would complement the Corporations Law.

Mr SINCLAIR—My other question is unrelated, but yesterday in your speech at Terrigal you talked about de-mutualisation of your membership. What progress has there been on that?

Mr Humphry—I may have lead with my chin on that issue, because it is a very sensitive area.

CHAIR—We are used to that with Terrigal conferences, but not always for the same reason.

Mr SINCLAIR—The pictures out of your Terrigal conference were not really anywhere as near as exciting as some others I can recall.

Mr Humphry—It is an issue which eventually will have to be faced. We had a situation where it was simply a case of history from the coffee shop to the trading floor. On the trading floor there are some 500 or 600 stockbrokers who were full members. Therefore, in a sense, they have an ownership of the exchange. When we automated the exchange, effectively the exchange was a separate entity and the members were not only owners of the exchange but also regulated by the exchange. In addition to that, they were looking for support services from us, which we found difficulty in providing. So there are three functions that the members are put in—as owners, as clients being regulated and as people seeking service provision from us.

In the longer term there are various options that we consider. One of them would be de-mutualisation, effectively floating the exchange—not listing it, I hasten to add, but floating it. That has been done successfully in Sweden. It is one option that might be considered in the future. It is of course a matter for members not for the managing director to force on them. It would require the members' agreement.

We recently had a referenda—I suppose you could describe it as had a vote taken by the members—on whether they would agree to moving to a corporate base membership because most of the activities on the exchange now occur through corporate broking houses. That was rejected, because it did not meet the required number for whatever reason. But it is only a matter of time before we have to reconsider the issue in the longer term. The 500 members that we have are ageing and there are not sufficient younger members coming through to take their place. So it is an issue which eventually will have to be addressed.

Mr SINCLAIR—Do your members accept the conflict between those three functions of the ASX?

Mr Humphry—I cannot speak for all of the members. I cannot say that there is a consensus view this way or that. But there is a general recognition that the exchange must carry out its regulatory functions independently. I remind the committee that the authority

for that is with the Australian Securities Commission, which has delegated it to the exchange and we act on their behalf.

I do not think the exchange can provide adequate service. We have been considering a range of possibilities, perhaps a professional institution or some sort of institute. I can certainly go part way towards it because one of the senior staff members of the exchange who started his career as a chalkie in the days when they did have open trading floors will be retiring shortly. He has agreed to take on the role of becoming a form of ombudsman, for want of a better term, as a sounding board for the broking community. I am sure they will welcome that development.

The third element, the question of ownership, is more difficult to address. In many instances the Australian Stock Exchange is a national institution. It has a range of responsibilities which might transcend just those of the brokers. It is a delicate area and one that I have to seek advice from other people on.

Senator COONEY—You talked about the simplification of the legislation and earlier you made a point that, because things are changing and developing all the time, you cannot legislate because you do not know if something will remain static for a long while. Do you think the problem with the legislation is that it is not simple enough, that we are not anticipating problems that arise early enough, or a bit of both?

Mr Humphry—I do not think it is possible to anticipate—I do not think anybody can anticipate—what the requirements will be in two or three years time, certainly not in 10 years time. I suggest that if one could cast the statutes in terms of principle, not get down into prescriptive process and then deal with those other matters through either schedule or regulation, there is a far greater chance of having a mechanism which will be able to respond to changes in the future. I believe this applies to many areas, not just to this industry.

You can achieve the objective in this industry by having legislation which is cast in a generic way, but which covers the principles and backs the business rules—which will be subject to scrutiny by the regulatory agencies—and which could be backed by force of law. That will work fine. It will give you the flexibility and the proper accountability of

the industry.

Senator COONEY—I think the inclination for any legislator is to say, 'We might well agree with that.' I remember that Michael Duffy, when he was Attorney-General, received a fair bit of criticism for not having statutes in place to meet the problems of the 1980s. Nobody likes to be criticised, but if you have a non-governmental body—whether it is a law institute or whatever—which is regulating things, and if the flack does fly, I suppose they have got to be prepared to come forward and say, 'Perhaps we should have done more,' instead of simply saying that government should have legislated. To be fair to Michael Duffy, I think that if that sort of thing had not been said at that time, we might have been in a different position now.

Mr Humphry—Senator, you are touching on a very difficult area. I agree with the observations that you are making. I cannot help many of the rules that we are saddled with today, which are a result of, and a reaction to, the 1980s. I do not think there is any way to solve that problem other than through a greater awareness in the public and through greater education. My fear is that the reaction to any of these circumstances—the Barings circumstance, for instance—will be to say, 'Let us have more regulation to protect,' when what we would be doing is simply stifling the market's function on risk. It is simply a case of people needing to understand what that degree of risk is. As long as they are properly informed and they can make a judgment accordingly, I believe that is as far as regulation should go. There are political problems with it. Our recent survey shows that there has been a 50 per cent increase in natural ownership of shares by persons in Australia. We have gone from 15 per cent to 21 per cent of all Australian adults directly owning shares—that is 2.6 million people. It is only a question of time before a greater interest occurs. This is because of the constituency issue. All their representatives in various parliaments will take an interest in this market. Therefore, we are embarking on a major education exercise. If we do not, the danger is that the view may be formed that we need to bring in more regulation to protect these investors. All that will do is act against the national interest. There is no solution to your overall problem other than education.

CHAIR—Thank you very much Mr Humphry, Mr White and Ms Byrne. As

always, it has been a very useful session. Mrs Bishop had to leave earlier. She indicated to me that she would try to get back because she wanted to ask a few questions. If we have not covered the areas that she was interested in, we might put those to you on notice and get you to answer them. They may have been overtaken by the assiduous questioning of Senator Cooney and Mr Sinclair. These public hearings are a very important part of the parliamentary process of doing our best to ensure that the Corporations Law is right in substance. Your contributions this morning will assist us in that process. Thank you very much. Good luck for your board meeting tomorrow.

Mr Humphry—Thank you, Mr Chairman. We are happy to assist the committee in any way we can.

CHAIR—I formally declare this public hearing closed.

Committee adjourned at 11.53 a.m.