

**SENATE STANDING COMMITTEE ON ECONOMICS QUESTION**  
**(Supplementary Budget Estimates 20 October – 21 October)**

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Question: SBT 198

Topic: Parameters for trading surveillance transfer of responsibility from ASX to ASIC

Senator Xenophon asked:

**Senator XENOPHON**—I am conscious that Senator Abetz wants to ask questions on this, but can you, on notice, provide details to the committee of the extent to which the parameters have been changed so that at least an attempt at a comparison can be made with what the ASX was doing, and also, for instance, on the issue of irregular trades. I think it would be useful information on the number of irregular trades that have been reported and there may be factors, if there is a difference, such as that the market is quite different than it was a year ago.

**Mr Tregillis**—I will take the question on notice in terms of the numbers of trades and the number of alerts. I can give you those figures. Again, I do put a caveat that the parameters are not exactly the same because we are using a slightly different system and we are using it for different purposes. As the chairman has said, for us the key issue is: are these alerts leading us to matters that are subject to further inquiries? The answer is yes, the 57 matters and the nine. That is, in fact, more than comparable to the types of issues being identified previously.

**Senator XENOPHON**—And you can tell us how the parameters have changed—that will not be a problem, will it?

**Mr Tregillis**—I would have to take that on notice. I do not have that detail. We have configured the system because it is a new system, and it is slightly different, so I am not sure that I will have exactly the information on how the parameters have changed. In terms of the numbers of trades and the number of alerts being generated as a percentage of trades, I can provide those figures.

**Mr D'Aloisio**—We will take that on notice, Senator, and be helpful. At the end of the day, we also need to be careful that how we set our parameters and how we vary our algorithms to what we look at and what alerts come up is quite important, sensitive information for the market. So I will just take it on board and we will see how we can help you.

**Answer:**

The ASIC market surveillance unit has detected a number of potential market abuses and this number compares favourably to the number of matters previously detected by ASX. This is not surprising as the people responsible for this work at ASIC were mainly responsible for this at ASX prior to the transfer and they are using similar tools and processes.

A key part of the implementation of market supervision at ASIC was to conduct due diligence of ASX's processes and procedures and implement those within ASIC as far as was practical. A critical part of this was to employ ASX staff with experience in the areas of market and participant supervision and we were successful in this regard.

The ASIC market surveillance and market analysis units comprise people previously experienced in market surveillance at ASX, a number of staff recruited by ASIC since September 2008 that have significant experience in markets and trading and existing ASIC staff with experience in market analysis and investigation of market misconduct. The Senior Executive responsible for Market and Participant Supervision was employed by ASX for 20 years including five years leading market surveillance operations. Surveillance analysts draw information from a range of sources in order to identify potential market abuse. These include market information systems, internally developed systems that identify unusual trading in equity and derivative markets, some ASX information systems for derivative and futures, broker research, news sources, market intelligence, non-public information available to ASIC regarding corporate actions and an alerting system (SMARTS) to identify unusual trading activity.

# Senate Standing Committee on Economics

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The SMARTs Market Surveillance System was chosen following a competitive tender and the package included a comprehensive set of alerts. SMARTs systems operate in 40 other jurisdictions. For the reasons set out below we did not consider that, in addition to the contract with SMARTs through the tender process, there was a need to separately pay ASX for similar alerts. We are confident that our alerts are detecting the same significant matters that ASX would have detected. We put in place a range of initiatives to ensure this was the case:

- We engaged SMARTs to assist us in the process of implementing and calibrating the alerts we use. SMARTs Group has significant global experience in calibrating market surveillance systems;
- One of ASX's Principle Surveillance Analysts joined ASIC prior to the transfer date to assist with alert calibration and implementation;
- We employed five of ASX's team of experienced market surveillance analysts which complemented our existing market analysis team.
- The ASIC Market Surveillance team conducted parallel alerting with ASX Surveillance for the month prior to 2 August 2010 and the two weeks post. During that time the two teams shared information relating to significant alerts in order to facilitate calibration of the ASIC SMARTs system. Changes were made to the calibration of the ASIC system to ensure that significant matters picked up by ASX were also picked up by ASIC.
- The ASIC Market Surveillance team continues to liaise with the ASX in relation to their alerts and to fine tune ASIC's portfolio of alerts and alerting process.
- In addition to our work with SMARTs and ASX we sought guidance from the Canadian Market regulator (IIROC) regarding its implementation of SMARTs.

Alerts and calibration are discussed in more detail below.

The parameters used by ASX were not available to the successful tenderer, SMARTs Group, as part of the tender process for the surveillance system and we did not have access to them as these were regarded by ASX as ASX's intellectual property.

We have recently had the benefit of reviewing the ASX alerts for the equity market and are of the view that the ASX and ASIC alerts will identify substantially the same matters that would be referred for further analysis.

We are confident that there are no fundamental differences in our approach.

The number of alerts we receive has been generally consistent with the alerts received by ASX. However there are fluctuations in the number received and our experienced team has been able to effectively review all alerts and identify matters for further review and a number of these have been accepted by our deterrence team in a faster timeframe than had been occurring prior to the transfer of market supervision to ASIC.

Some types of alerts are:

- Price and volume alerts where market activity is beyond the normal range for a security. E.g. The price has risen quickly and beyond the normal trading pattern of the particular security.
- Market manipulation alerts - for example identifying where orders are placed to set the closing price of a security (known as "marking the close").
- Excessive activity alerts - to identify badly written algorithms or an attempt to give the perception of stronger supply or demand than exists.

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Each alert has a number of parameters that can be adjusted to fine tune the system - this is sometimes referred to as "calibration". This is necessary to ensure the alerts received are useful and is a continual process. This process commenced more than two months prior to the commencement of market surveillance at ASIC and was conducted with the assistance of one of ASX's "Principal Analysts" from its market surveillance unit who transferred to ASIC on secondment in early July. During calibration alert parameters are set broadly and then refined to eliminate false positives. Alert parameters that may have been relevant 12 months ago may not be relevant today or those being used today will not necessarily all be relevant in 12 months time. We regard this process of reviewing alert parameters as ongoing given changes in trading strategies, new market players, changes in technology and other market developments.

Alert parameters are treated as strictly confidential by ASIC to prevent gaming of the surveillance system by traders. That is, to prevent traders from flying just under our radar.

With regard to derivative markets our due diligence indicated that some new tools and different skills were required. We have completed the first step in this which was to bring together a range of staff skilled in derivatives trading and analysis. The next stage will be to further develop our systems to identify unusual activity in the derivatives market to complement our existing systems.

ENDS