CHAPTER 3

DISADVANTAGES AND SHORTCOMINGS

Introduction

3.1 This Chapter examines disadvantages or perceived disadvantages identified in the evidence and submissions. It also looks at the ASX's response to the major issue, namely the perception of possible conflict of interest arising from the ASX supervising organisations against which it also competes.

3.2 While many submissions and witnesses supported the current framework for market supervision, several criticised the framework. Some, while supportive of the overall approach, identified shortcomings in limited areas. The ASX itself falls into this category, as does IFSA.

3.3 Other submissions were far more critical, identifying what they saw as major disadvantages. Dr Shann Turnbull, for example, contended that the market supervisory framework is fundamentally flawed because of what Dr Turnbull identified as a lack of transparency in trading, permitting market manipulation.

3.4 The submissions and evidence of Computershare, IFSA, Mr Ross Catts, the Australian Shareholders' Association and Boardroom Partners addressed the major issue of the inquiry, namely conflicts of interest between ASX's supervisory and commercial objectives. Computershare contended that the ASX's continued supervision of listed companies that are also commercial competitors gives rise to what Computershare argued is an irreconcilable conflict of interest that cannot be addressed within the current framework. Computershare argued that the ASX's expansion of its activities into areas occupied by other companies created potentially unfair competition.

3.5 IFSA's submission and evidence addresses an issue that relates to the balance ASX must strike between meeting commercial and supervisory obligations, operating a market dependent on information flows. IFSA expressed concern about the implications of ASX charging for information previously provided free. Mr Catts and the ASA also had concerns about the availability of information in a post demutualisation commercial environment.

3.6 In the following sections of this Chapter, the Committee examines the disadvantages of the current framework, which fall into the following broad categories:

- shortcomings identified by the ASX itself, predominantly related to rigidities, duplication and costs;
- transparency of trading issues;

- perceptions of conflict between supervisory and commercial objectives; (for example, through new charges imposed for the provision of information and restrictions on the availability of information); and
- potential conflicts of interest relating to market supervision of ASX competitors arising from ASX expansion of commercial activity.

3.7 The latter two points are identified separately for the purposes of this discussion but in reality, the two are closely related. Both originate from the ASX's demutualisation and expansion into new commercial territory through the vertical integration of related services.

Shortcomings identified by the ASX

3.8 As noted above, the ASX argued forcefully for the retention of a supervisory framework based on the co-regulatory model. Clearly, the ASX believes that this is the best approach to market supervision. Nonetheless, the ASX expressed concern about a number of aspects of the current arrangements. Predominantly, these concerns related to the direct costs to the exchange of implementing the supervisory framework, and indirect costs associated with a perceived lack of flexibility and management of authorisation and approval processes.[1]

3.9 The ASX drew a distinction between shortcomings in the regulatory framework and those in its own supervisory framework. Within the regulatory framework the exchange identified what it sees as the following shortcomings:

- the detailed prescription that applies to market supervision;
- a lack of flexibility in the current legislative framework for the National Guarantee Fund (NGF), rendering it incapable of accommodating future needs and general industry developments; and
- rigidities with the current structure in the context of ASX's international alliance proposals.[2]

3.10 The ASX expected that the FSR bill would address some of these shortcomings:

> One of the great benefits of the FSR Bill will be to allow us to separate the NGF's clearing support function from the NGF's function of protecting investors/consumers from 'improper' conduct by Participating Organisations. This will be consistent with overseas models…
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> …

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1 ASX, Submission No. 2, p. 4.

2 ASX, Submission No. 2, pp. 7-8.

> The Bill…provides long overdue harmonisation of regulatory treatment of securities and futures. It also moves towards a more principles based, flexible regime.

3.11 However, the ASX remained of the view that despite the changes to be introduced by the Bill, shortcomings in the framework would remain:

> …it does not diminish the level of regulation and thus of regulatory costs faced by securities exchanges. Nor does it change the fundamental approach to the supervision of securities exchanges.[3]

3.12 The ASX sees these alleged shortcomings as important because of the costs that flow from them. These costs are both direct, adding to transaction costs, thereby decreasing the ASX's ability to compete for liquidity on a global capital market; and opportunity costs incurred by the exchange itself, handicapping its efforts to expand its range of products and services. At a primary level, these opportunity costs limit the ASX's opportunities for generating revenue. This might be thought to be of concern only to the ASX's shareholders, but the ASX argues that there are wider ramifications, as the range of services and thus efficiencies it can offer potential clients contributes to its ability to compete for liquidity on a global market.

3.13 The exchange reminded the Committee that Australia's share of the global capital market is very small, pointing out that in the MSCI World Index, which is widely used as the basis of asset allocation by international fund managers, Australia accounts for approximately 1.43 per cent of the global market. It argued that investors would be cautious about investing in the Australian market instead of foreign markets if they are not confident they can liquidate their investments readily and at low cost. The factors identified by the exchange as having influence over liquidity were information, transaction costs and market security and integrity.[4]

3.14 The ASX's efforts to remind the Committee of these issues appear to be based on what can be distilled to a fairly simple message: regulators (and by implication, legislators) should be mindful of the flow-on effects of regulatory compliance costs on Australia's ability to compete for capital on a global capital market. Investors and the issuers of financial products will seek the security offered by a high integrity market but will also be influenced by efficiencies in and costs of transacting business in that market. As such, operating a successful and globally competitive market requires careful balancing of market integrity measures (supervision and regulation) against the cost associated with achieving that integrity. Both over-regulation and inadequate regulation have the potential to be damaging.

3.15 The ASX separately identified what it described as inadequacies in its own rules, focussing on the degree of detail and prescription, duplication of requirements embodied in law and corporate governance requirements:

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[3] ASX, Submission No. 2, pp. 7-8.

[4] ASX, Submission No. 2, p.7.

> Our rules tend to be very detailed and prescriptive. In the business conduct and client relationship areas, rules often duplicate or supplement Corporations Law requirements or common law principles. Our listing rules include corporate governance rules concerning management of a listed entity and its daily operations which do not have a directly evident effect on the market.

3.16 The exchange expressed concern about the resulting compliance costs and how these might affect its customers, observing that the situation may be exacerbated over time.

3.17 The ASX expressed a desire to divest itself of the responsibility for aspects of the business conduct and client relationship rule framework, suggesting that either ASIC or an appropriate industry body regulate and enforce these aspects of market supervision. The exchange did not think that this would compromise the market but rather would 'allow us to concentrate our supervisory efforts on matters which are essential to the maintenance of market integrity and efficiency'.[5]

3.18 In this regard, the Committee also notes the evidence from Mr Richard Humphry, Managing Director and Chief Executive Officer, ASX, that the ASX has:

> …no powers of regulation. We have listing rules and we have business rules…We are not resiling from our responsibilities here, but we are trying to point out that we are not an extension of government, we are not a government agency. We are running a market as a market operator and we are licensed.[6]

3.19 The Committee accepts the validity of some of the exchange's arguments, particularly in relation to the responsibility that rests on both the operator and regulatory authorities to operate as efficiently as practicable. The Committee also accepts that the ASX wishes to maintain the integrity of the market and has a strong vested interest in doing so. However, the exchange's views about the level of regulatory safeguards required to maintain market integrity cannot be regarded as disinterested. The Committee considers that ASIC and the Minister should consult with all stakeholders before making the changes to the regulatory framework sought by the ASX itself.

Transparency issues

3.20 In his submission, Dr Shann Turnbull argued that the present framework is fundamentally flawed because of what he considers to be a lack of transparency in trading. Dr Turnbull identified the following issues as shortcomings:

- investors are not allowed to know the identity of the counter party when they are buying or selling securities;

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5 ASX, Submission No. 2, p. 9.

6 Evidence, pp. 21-22.

- those who control the trading of securities can hide their identity through nominee companies; and
- the relationship between the beneficiaries of securities and the controllers is hidden.[7]

3.21 Dr Turnbull argued that the existing framework, by not disclosing identities and relationships between persons trading securities, provides opportunities for market manipulation, necessitating complex and costly regulatory activity to control it. He said:

> The existing framework facilitates, protects and so promotes opportunities for unethical activities. It creates markets that are both inefficient and unequitable. It introduces the need for extensive, intrusive and costly prescriptive laws, regulation and official monitoring of market activities.[8]

3.22 Dr Turnbull advocated a trading regime described as 'sunlight trading', under which the identity of buyers and sellers of securities must be fully disclosed before trading takes place, and continuous disclosure requirements re-directed from corporations to individuals. Dr Turnbull contended that under this system, market leading or manipulation as a result of access to privileged information would be impossible. He considered that a sunlight trading regime would enable exchanges to be essentially self-regulating. He concluded that under such a regime, market manipulation through insider dealing and price manipulation would be made much more difficult:

> The existing system of trading securities is inconsistent with transparency and the introduction of self-regulation. As a result it has produced extensive intrusive regulation and costly monitoring with inadequate and dubious benefits. Full transparency to facilitate self-regulation would significantly reduce the need for complex prescriptive laws, regulation and monitoring. To obtain the privilege of obtaining negotiability of their investments, shareholders must forgo the right to privacy and anonymity. Concerns for privacy and anonymity are inconsistent with the public interest in establishing both a fair and efficient public market in securities.[9]

3.23 Dr Turnbull's recommendations for achieving the required transparency in the market's operations were as follows:

> (i) [As] a condition for <u>any</u> company being allowed to remain registered is that it be required to provide on a web page for public inspection without charge all the information which it must make publicly available by law or by <u>any</u> regulator;

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7 Dr Shann Turnbull, Submission No. 3, p. 1.

8 Dr Shann Turnbull, Submission No. 3, p. 1.

9 Dr Shann Turnbull, Submission No. 3, p. 3.

> (ii) Only allow corporations and other types of issuers to have their securities publicly traded on condition that legal title will only be recognised by the issuer if:
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> > (a) The vendor discloses the parties who directly or indirectly control the authority to dispose of the security to the purchaser before execution of a trade;
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> > (b) Any change in the parties who directly or indirectly control the authority to dispose of the security is reported to the issuer who at the same time makes this information publicly available through a web page linked to the parties executing the trade; and
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> > (c) The holder of a security reports to the issuer the relationship between parties who control directly or indirectly the trading of the security and the beneficiaries of the securities.[10]

3.24 The ASX rejected Dr Turnbulls's proposals:

> …we believe that the platform, which you saw a demonstration of today, is at the transparent end of the global spectrum in relation to markets. We do not believe that the kinds of sentiments expressed in the Turnbull submission have any basis in fact.[11]

3.25 While sympathetic to Dr Turnbull's commendable aim of promoting integrity within the market, the Committee is unconvinced of either the need for or practicality of his proposal. While examples of attempts at market manipulation and companies failing to comply adequately with their continuous disclosure obligations can always be found, the Committee has received little evidence to suggest that problems in the market are widespread, or that the supervisory framework is inadequate in performing its task. The Committee considers that the continuous disclosure requirements imposed on companies traded on the ASX also provide much of the transparency sought by Dr Turnbull. Other laws dealing with the disclosure of directors' interests and changes in significant holdings also add to the transparency of the market.

3.26 Most other commentators, including those with much to lose if the market were operating other than with integrity, have also supported the current system.

3.27 Further, from what the Committee has seen of the ASX's sophisticated monitoring program, there is reason to believe the market is being monitored effectively, minimising opportunities for manipulation.

3.28 The Committee would be concerned at any proposal to unilaterally introduce the system proposed by Dr Turnbull as it would place the Australian market at odds with practice in most other markets and may open up opportunities for arbitrage.

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[10] Dr Shann Turnbull, Submission No. 3, p. 3.

[11] Evidence, p. 28.

Potential conflict between supervisory and commercial objectives

3.29 Several submissions identified a possible conflict for the ASX between its post demutualisation and listing obligations to return a profit to shareholders by engaging in commercial activity, and its continuing obligations to supervise market operations.

3.30 The Treasury submission defined the nature of the problem:

> …demutualisation and changes to exchange ownership and organisation have the potential to expose tensions between exchanges' supervisory obligations and their commercial objectives to maximise profits for the benefit of shareholders. While the operation of proper supervisory practices is likely to be seen by exchanges as consistent with profit maximising objectives over time, the tension that is created by demutualisation could manifest itself, or just as importantly for market integrity, be perceived by market participants to manifest itself in a number of ways – for example, insufficient devotion of resources by an SRO to its regulatory function, or the calling into question of its capacity to supervise a listed entity with whom it was in direct competition.[12]

3.31 The Treasury advised the Committee that because of these potential conflicts, one of the Government's key policy objectives must be to ensure that the board and management of an exchange pay sufficient attention, and devote sufficient resources, to the task of maintaining a well functioning market.

3.32 This issue manifested itself during this inquiry not so much in terms of the amount of resources that the ASX devotes to supervisory responsibilities, but rather the ASX's maximising revenue through the imposition of fees and charges for information formerly provided free. Submissions on this subject appear to have been provoked by several different but related issues, including:

- the availability and commercialisation of information; and
- standards of listed companies.

Availability and commercialisation of information

3.33 Several witnesses pointed to apparent changes in the ASX's policy of charging for information that was previously free as one aspect of commercial imperatives affecting the exchange's ability to run a fair and orderly market.

3.34 The availability of information is accepted as essential to market integrity and indeed, continuous disclosure requirements are central. However, investors also use a range of other information produced by the exchange, a proportion of which they regard as constituting a 'public good', a necessary part of the exchange's operations. One of these items of information is market indexes.

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12 The Treasury, Submission No. 5, p. 5.

3.35 Historically, the ASX produced a range of indexes, such as the all-ordinaries index, which tracked market movements. The ASX has, however, sold its index business to Standard and Poor's (S&P). IFSA advised the Committee that S&P have now sought to licence the use of the indexes:

> What was essentially a public good and not charged for under the old demutualisation structure subsequently became a revenue generating item as a demutualised company.

3.36 IFSA told the Committee that demutualisation has called into question many of the assumptions market participants have held in relation to the services provided by the ASX. IFSA questioned whether ASX had struck an appropriate balance between its market operator and commercial roles in this case:

> We consider that the public interest nature of the services provided by ASX must be balanced against the need to promote the interests of shareholders…
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> I guess the issue really comes down to the fact that, on the one hand, the ASX see things like market information as an asset which they can generate a return from. On the other hand, as investors we see that information as something that makes the wheels of the marketplace move.[13]

3.37 IFSA acknowledged that the payment of fees for information was not a major issue for most of its members. However, it pointed out that for small shareholders, the issue was more important due to their more limited resources. Two other submissions, those of the ASA and Mr Ross Catts, elaborated on this theme.

3.38 Mr Catts, an individual investor, complained about what he saw as 'the expense and cumbersome nature of comprehensive access to information disclosed by ASX listed entities'. He claimed that as a result, 'the benefits for the efficient allocation of capital in the economy that can flow from a well informed investing public are not being realised'. In Mr Catts's view, this also leads to an inequity between institutional and private investors, institutional investors having a comparative advantage.[14]

3.39 Mr Catts identified September 1996 as a turning point in the quality of information available to individual investors, a time when the ASX was contemplating demutualisation. Up until that time, all disclosures were available on microfiche but subsequently, only on computer database. According to Mr Catts, costs to the small investor of obtaining detailed market information, beyond that available via signal G, have escalated to the point that they are prohibitive:

> Printouts from ASX's MAPS database, obtained via telephone or fax requests, then post or fax dissemination, cost $5.50 file access fee plus $0.44

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13 IFSA, Submission No. 10, p. 4.

14 Mr Ross Catts, Submission No. 9, p. 9.

> per page plus postage. Many disclosure documents are over 100 pages and are expensive items to the point where many investors are deterred.[15]

3.40 Signal G also incorporates a 20 minute delay from the time of announcement, whereas institutional investors can have access to real-time data via systems such as Bloombergs, which also provide (for a fee) the detailed information of the kind sought by Mr Catts. This also places the small investor at a disadvantage to the larger investor, although it must be acknowledged that this would probably only make a difference for that very small number of individual investors who were operating as day traders.

3.41 Nonetheless, there is a perception in some areas that the ASX's practices in respect of information provision create two classes of investor. Mr Dudley Chamberlain, Senior Executive, Computershare, drew the Committee's attention to an article written by Stephen Bartholomeusz which, he maintained, identified the nub of the problem:

> The basic problem, however, is that even after improving access to corporate information, by editing company announcements and by charging those who want immediate access to the full unedited version of those announcements, the ASX creates two classes of investor – those who can afford to pay for instant and complete information and those who can't.[16]

3.42 Mr Ted Rofe, Chairman, ASA, supported a number of the views put forward by Mr Catts. Mr Rofe advised that the ASA's recommended approach to addressing the availability of data is to require listed companies to post it on their websites:

> Our current approach is that, as a condition of listing, all listed companies should be required to maintain a web site on which they publish statutory information – annual reports, continuous disclosure information – as soon as it is released to the ASX. As more than two-thirds of companies are already doing it, there is no good reason why all listed companies should not have a web site.[17]

ASX response

3.43 The ASX rebutted suggestions that there has been a drop in the access and quality of information since demutualisation, arguing that the reverse is true. In a supplementary submission, the ASX contented that since demutualisation, it had substantially reduced the cost of access to real time market data and continuous disclosure information.

3.44 Addressing the issue of the 20 minute Signal G delay, Mr Humphry advised the Committee that this was in accordance with international general practice. The

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15 Mr Ross Catts, Submission No. 9, pp. 2-3.

16 Quoted in Evidence, p. 55.

17 Evidence, p. 66.

exchange also claimed that prior to demutualisation the delay was 8 hours. Summing up its response to Mr Catts, the ASX asserted that:

> These changes, combined with the continuing growth in on-line access by private investors, has meant that the average investor now has more information concerning ASX markets available to them than at any time before ASX demutualised.[18]

3.45 The ASX also addressed the cost of information issue raised by Mr Catts and others, pointing out that there are costs associated with receiving, storing, processing and disseminating continuous disclosure documents. Mr Humphry explained:

> [But] I think it is a mistake to think that the ASX somehow gathers information in a costless way and then sends it out and somehow clips the ticket. We have to reorganise that information and compile it in a way so that it is a signal which is going out in a coherent manner. The cost of actually gathering all that information, coordinating it and streaming it - we have about a dozen signals that we send out - is not something which is costless.[19]

3.46 The exchange maintained that the fees charged are to recoup these costs and are in line with similar fees charged by ASIC.[20] Mr Humphry argued that if there were a requirement that all information had to be provided free, the costs of this would have to be recovered elsewhere:

> If the community says we will have that information for nothing, what that will tend to mean is that the total cost of all of that provision of information will simply arise through some other mechanisms, through trading figures or whatever.[21]

3.47 The ASX also point to technical difficulties associated with supplying complete continuous disclosure information in the quantity and detail sought by Mr Catts and others. Mr Humphry told the Committee that limitations on internet technology complicated the task of getting information out more quickly. An example of this is that it would take up to 2 hours 42 minutes for an average internet connection to download a disclosure document made up of 35 megabytes.[22] In Mr Humphry's assessment, the ASX is 'getting it about as fast as we could probably serve it to them'.[23]

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18 ASX, Submission No. 2B, p. 9.

19 Evidence, pp. 23-4.

20 ASX, Submission No. 2B, p. 10.

21 Evidence, p. 23.

22 ASX, Submission No.2B, p. 9.

23 Evidence, p. 24.

3.48 A possible solution to the obstacles faced by smaller investors in obtaining information is the reintroduction of the ASX library system, offering access to computer terminals. This would give individual investors access to these documents but would only assist investors in major cities. A further solution would be to encourage listed companies to make better use of web pages. This would involve companies posting information on their websites at the same time as they release it to the ASX. This would eliminate the 20 minute Signal G delay. The time to download large documents is likely however to remain a problem for the average internet connection.

3.49 The Committee sought ASIC's view about the provision of information to the market by the ASX and whether it is reasonable to charge to disseminate information. ASIC's Deputy Chairman, Ms Jillian Segal, affirmed the importance of the dissemination of market information, noting that a number of other markets have previously charged a fee for information and are now moving away from charging.[24]

Standards of listed companies

3.50 A further possible manifestation of commercial objectives clashing with supervisory requirements was identified by Boardroom Partners, a 'boutique consultancy formed to provide corporate governance advice to a wide range of enterprises',[25] who questioned how the need to satisfy the income requirements of ASX shareholders fits with the equally important need to regulate the market for shares in listed companies. Boardroom Partners pointed out that 'surveillance, investigation and enforcement is a drain upon profits'. They acknowledged that without expenditure on these items the ASX's reputation would suffer, but maintained that 'there is little financial incentive for the ASX to maximise its expenditure and involvement in this important activity'.[26]

3.51 Boardroom Partners maintained that the collapse of a number of companies illustrates its point. Boardroom Partners contended that many of these companies should not have been allowed to list because of past failures of directors and inadequate capital. They also implied that both the ASX and ASIC had failed in their monitoring of the continuous disclosure requirements. The conclusion that Boardroom Partners appeared to be drawing was that investors may believe that the ASX is reluctant to regulate listed companies to the fullest because of the cost of doing so.[27]

3.52 The Committee also sought information from ASX about the same matter, asking about media allegations that the ASX had reduced listing standards in order to attract listings. The ASX responded to these issues by denying that it had dropped listing standards since demutualisation. It pointed out that ASX's market admission

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24 Evidence, p. 10.

25 Boardroom Partners, Submission No. 11, p. 2.

26 Boardroom Partners, Submission No. 11, p. 5.

27 Boardroom Partners, Submission No. 11, p.5.

criteria require companies wishing to be listed to satisfy minimum standards of 'quality, size, operations and disclosure' and sufficient investor interest demonstrated. The exchange concluded that neither it nor ASIC make judgements about the investment worthiness of a company. The disclosure and transparency requirements assist investors to make their own decisions about this matter.[28]

3.53 The Committee also notes that Boardroom Partners' assertions about a lack of incentive to maintain integrity are directly contrary to the ASX's evidence and that of a number of other significant commentators who argue that the contrary is true – that ASX does have a strong vested interest in maintaining integrity. The Committee also notes that in 2001 the ASX commenced posting its proposed listing rule changes on its website and inviting comments on proposed changes.[29] The Committee encourages the ASX to continue with this practice in order to ensure that all interested people can participate in the rule-making process and to ensure transparency in the process. The Committee was also advised by Treasury that the Minister for Financial Services and Regulation has a power to disallow listing rule changes.

3.54 The ASX also has a power to waive listing rules and maintains a public register of listing rule decisions.[30] Treasury advised the Committee that ASIC is advised of listing rule waivers and monitors the circumstances in which such waivers are granted.

3.55 The Committee believes it is essential that the Minister and ASIC exercise their responsibilities diligently in order to ensure accountability in, and transparency of, changes in operating rules and any waivers from those rules. The Committee also recommends that the register of listing rules decisions include reasons for those decisions – subject to considerations of commercial confidentiality – and be available on the ASX website.

Potential supervisory conflicts of interest

3.56 The ASX is in the process of expanding beyond its core listing and trading services into other areas such as registry and information services. For example the ASX has acquired interests in Bridge DFS, a company providing desktop information services to the investment industry; Orient Capital, a strategic investor relations group; and a share registry organisation now known as ASX – Perpetual Registrars. The ASX's commercial activity brings it into possible competition with other established

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28 ASX, Submission No. 2B, p. 1.

29 This change follows controversy in mid 2000 when the ASX relaxed listing rule requirements applying to shareholder approval of employee incentive schemes. Under the listing rule change, which press reports suggested took many within the industry by surprise, approval requirements were reduced from 75% of shareholders to 50%. IFSA subsequently disagreed with the change, urging company compliance with its Corporate Governance guidance notes instead of the lower ASX requirement. A major reason for controversy surrounding the change appears to be that it came into effect before many within the industry were even aware of it. ASX's initiative to list proposed changes on its website should avoid future controversy of this nature.

30 ASX, Submission No. 2, p. 13.

providers of these services. For example, Computershare is a large international company that competes with the ASX for business in several of these areas.

3.57 While competing with these other service providers, the ASX nonetheless has a continuing responsibility to supervise its competitors, giving rise to perceptions that conflicts of interest may arise. A similar issue exists in respect of the demutualised exchange supervising itself as a self listed entity, although this issue is comprehensively covered in a Memorandum of Understanding (MOU) between ASX and ASIC.

3.58 Computershare Ltd's submission was one of the more prominent that raised the issue of conflicts of interest arising from the ASX's moves into new spheres of activity. However, a number of other submissions also commented about the same matter. Boardroom Partners also considered that the potential for conflict of interest was an inevitable consequence of a demutualised ASX diversifying into new commercial activities. They questioned whether the supervisor of the listing rules could monitor its own activities.

3.59 Computershare explained that it considered the ASX's power to set and apply trading rules could give it the opportunity to use this power to further its own interests at the expense of competitors, creating a major and untenable conflict of interest. Computershare illustrated its point in the following terms:

> We are now in a situation where a publicly listed company, the ASX, is able to make rules that may well supplement the law but are potentially capable of being anti-competitive in nature. By having the power to make and implement business rules and prescribe technical processes, the ASX have the potential to create actual commercial benefits for the ASX and rules that could favour the technical platforms of their commercial adjacent businesses, such as APRL – which is the share registration service – Orient Capital and Bridge.[31]

3.60 Computershare also questioned the transparency of the rule making process, contending that 'there is much less scope for transparency and review in the rule making process':

> Computershare's argument is that the ASX is in a position to exploit the advantages it gains from being the market operator to compete unfairly, use information about companies, proposed rule changes and proposed future changes to technology to create commercial advantage for itself.[32]

3.61 Computershare used the example of a seminar conducted by the ASX which was allegedly used as a vehicle for promoting Orient Capital to illustrate how the market can easily perceive a conflict of interest between the ASX's commercial

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31 Evidence, pp. 52-3.

32 Evidence, p. 53.

objectives and its supervisory activities. In response, the ASX strongly denied any improper behaviour but did acknowledge in evidence that adverse perceptions might mean that such events should be more clearly separated in future.[33]

3.62 Computershare's proposed solution to the perceived problem was essentially to break up the ASX's vertically integrated operation. They proposed the 'ring fencing' of ASX's commercial activities from its supervisory roles through the establishment of separate companies with separate ownership and governance to undertake these roles, and separating the management and supervisory function of ASX, SEGC and ASTC from ASX management of commercial business operations.

3.63 Computershare also proposed regulation to control anti-competitive activities covering areas such as:

- price control on monopoly areas to stop monopoly rents being extracted, at least while the monopoly exists; and
- prohibiting cross-subsidisation from monopoly areas to contestable areas.

3.64 Perhaps the most significant change proposed was the removal of the regulatory and rule making power from ASX, this function to be performed instead by ASIC.[34]

3.65 The ASX defended itself vigorously against Computershare's assertions. While acknowledging that diversification can create the potential for conflicts of interest, the ASX reminded the Committee that it is subject to legislative requirements (for example, s46 of the Trade Practices Act) that prevent abuse of market power. Further, it has introduced new measures (in particular ASXSR) to address the issue.

3.66 The exchange told the Committee that the concerns about conflicts of interest were based on perceptions and fears, not reality:

> Commentators who are critical of ASX tend to talk in generalities about perceptions and fears – tangible examples of actual conflict having compromised ASX's supervisory effort are not cited. That is because ASX's supervisory conduct is and continues to be diligent, professional and even-handed.[35]
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> …
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> The Computershare submission does not present a single example of misuse of ASX supervisory power in this area. Nor could it. The Computershare

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33 See discussion between Senator Conroy and Mr Humphry at Evidence, p. 22.

34 Computershare, Submission No. 4, p. 13.

35 ASX, Submission No. 2A, p. 2.

> submission, as conceded in evidence [at page E59-60] is motivated by self-interest.[36]

3.67 The Committee also notes that in evidence Mr Humphry said the ASX would not extend into commercial activities 'which would really inhibit our supervisory role'.[37] Nevertheless, the Committee is conscious that the ASX needs to be careful to balance its supervisory functions with its commercial interests. Mr Shane Tregillis, National Director, Policy and Markets Regulation, ASIC, best summed up the issues faced by ASX in this regard:

> There is the potential for a conflict of interest between their role as the market operator and regulator and the commercial interests. ASX performs, as it has set out in the submission, a whole range of important regulatory functions – its listing and business rules. So for important regulatory purposes, its infrastructure has important regulatory aspects to it. I think I would agree that it needs to be very careful that when it is dealing with its participating organisations or listing companies on regulatory matters that it, as far as possible, seeks to separate out commercial ventures that it might be dealing with.[38]

Addressing the conflicts of interest issue - ASX Supervisory Review

3.68 The ASX's major initiative in response to the perceptions about possible conflicts of interest is the establishment of the new subsidiary company, ASX Supervisory Review. The next Chapter deals with this body.

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36 ASX, Submission No. 2B, p. 5.

37 Evidence, p. 30.

38 Evidence, p. 10.