ASX
AUSTRALIAN STOCK EXCHANGE

MEDIA RELEASE

15 December 2005

ASX reinvigorates market supervision. Provides more resources to strengthen investigation and enforcement; New supervisory structure is demonstrably more independent.

ASX is committed to retaining its supervisory role. As part of that commitment, ASX conducted a review of its supervisory role, structure and processes. That review is now complete.

The outcomes of the review were announced today by ASX's Managing Director and CEO, Tony D'Aloisio, and the Group Executive Market Supervision, Eric Mayne.

"ASX is today reinvigorating its market supervision. We are providing more resources to strengthen investigation and enforcement, and we are creating a demonstrably more independent operational structure for supervision," Mr D'Aloisio said.

"The new arrangements will help give ASX a significantly improved platform to project a revitalised and more competitive presence in the Australian marketplace and in the wider region," he said.

Mr Mayne said: "ASX's markets are highly regarded for their integrity and transparency. ASX has a strong track record in carrying out its supervisory activities. Business, Government and ASIC have confidence in the way ASX carries out its supervision activities. There is also widespread support from participants and listed companies for ASX to retain the supervision role."

"Our objective is to continually improve. Accordingly, as a result of the review, ASX has decided to make a number of improvements to supervision that will maintain and strengthen market integrity, minimise costs of compliance and strengthen confidence of listed entities and investors," Mr Mayne said.

Full details of all changes are provided in the attached document. The key outcomes of the review of supervision are:

1. **ASX will commit significant additional resources to further strengthen market integrity.** ASX will dedicate more resources to detecting insider trading by establishing a specialist unit within its Surveillance team. Additional technological and training resources will be provided to further improve supervision of listed entities and market participants. Further additional resources are being directed at promoting corporate governance disclosure through the ASX Corporate Governance Council.

2. **To reduce complexity and compliance costs, and remove areas of duplication, ASX will rewrite and simplify its Operating Rules** (the Market Rules covering market participants and its Listing Rules covering listed entities) **using modern principles-based drafting.** Keeping compliance costs low boosts Australia's ability to maintain an attractive low cost of capital.

3. **ASX has identified a number of ways of removing duplication and improving efficiency and productivity in its internal processes.** These process reforms follow on from the internal reorganisation of its Market Supervision Division and the alignment of rewards and performance measures for all supervisory staff.

4. **To minimise further the perception of conflict between ASX's regulatory and commercial functions, ASX will place its supervisory operational functions in a separate subsidiary company.** The head of the supervisory functions, currently the Group Executive Market Supervision, will be known as the Chief Supervision Officer (CSO) and will continue to make all operational supervisory decisions. The CSO will not report to the CEO of ASX as at present but will report to the Board of the subsidiary company, which will include external directors. All existing internal and external controls to manage conflicts, including the roles of ASIC and ASX Supervisory Review, will continue.

5. In line with the approach taken by the Government for ASIC and APRA, **ASX has separated regulatory policy decision making from supervision or enforcement decisions** by establishing a Regulatory Policy Unit. The RPU will report to the CEO of ASX.

6. **ASX will continue to fund and be responsible for the costs of market supervision.** Funding will be provided through a transparent 3-year rolling budget, within disciplines around efficiency and productivity increases. Where additional investment is needed, and made, ASX will pass this on through increased annual listing fees.

7. In summary the additional costs of these improvements, over and above Supervision's current (2005-06) expense budget, are as follows:

Costs	2006/07	2007/08	2008/09	Total
Capital	$3.525m	$1.375m	-	$4.9m
Recurring	$2.887m	$1.497m	$1.141m	$5.525m
Total	$6.412m	$2.872m	$1.141m	$10.425m

The capital component has been budgeted to be absorbed within ASX's current capital expenditure budget. Recurrent items will be passed on through increases to annual listing fees to apply from 1 July 2006.

A number of the improvements coming out of the Supervision Review have already been put in place or commenced. They are the new internal structure for Market Supervision, establishment of the new Regulatory Policy Unit, additional resources for corporate governance, rewrite and simplification of ASX's Operating Rules, new performance measures for all staff, and the continuous improvement initiatives to drive efficiency and remove duplication of internal processes.

The specialist insider trading unit will be established from 1 March 2006 and the new supervision subsidiary will be fully operational from 1 July 2006. These improvements may be refined further with the benefit of consultation and input from ASIC, Treasury, Government and industry (where appropriate), and any further decisions will be made by the ASX Board in March 2006.

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ATTACHMENT

ASX REINVIGORATES SUPERVISION -
MORE INDEPENDENCE AND MORE RESOURCES TO STRENGTHEN INVESTIGATION AND ENFORCEMENT

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Section 1: Track record of Supervision

1.1 Providing a market that is fair, orderly and transparent through vigorous supervision is central to ASX's business and a core value in everything it does. As a licensed market operator, ASX is obliged by law to provide it, and as a business entity, its reputation and attractiveness to customers and investors depend upon it.

1.2 Strong supervision of ASX's markets strengthens the confidence listed entities have in raising capital on its markets and the confidence of investors to trade on its markets. Central to maintaining that confidence (and hence the business at ASX) is the way ASX supervises its markets, the way ASX maintains an appropriate balance between strengthening market integrity and minimising the costs of compliance with ASX's Operating Rules, and the co-operation between ASX and other regulatory bodies like ASIC and ACCC.

1.3 The Market Supervision division of ASX oversees compliance with ASX's Operating Rules. This involves:

- Supervising listed entities;
- Supervising trading activity in the market;
- Supervising market participants such as stockbrokers and clearing and settlement participants; and
- Meeting the regulatory obligations of ASX under the Corporations Act.

1.4 ASX is committed to its supervisory role and there is strong evidence that ASX performs well in carrying out its supervisory activities and that ASX's markets are highly regarded for their integrity and transparency. Business, Government and ASIC also have confidence in the way ASX carries out its supervisory activities.

1.5 ASX has a strong track record on supervision and enforcement. Last financial year, ASX:

(i) Released 93,562 company announcements to the market (an average of 56 per company) of which 23% contained sensitive information.

(ii) Applied 768 trading halts and 395 suspensions to listed companies.

(iii) Detected 83,917 alerts for potentially inappropriate trading incidents; 324 of which were investigated further.

(iv) Made a total of 2,370 queries of listed entities regarding their compliance with continuous and periodic disclosure obligations (an increase of 53% on 2003/04).

(v) Notified ASIC of 107 suspected breaches of ASX Rules or the Corporations Act for matters such as continuous disclosure and insider trading.

(vi) Fined brokers $533,500 for contraventions of ASX Rules.

(vii) Upgraded its real-time electronic market monitoring and alert system (SMARTS) to provide more effective surveillance of equities trading and more effective surveillance of the derivatives market.

(viii) Promoted the disclosure requirements of listed entities against the ASX Corporate Governance Council's 10 principles and 28 recommendations. ASX reviewed 1,222 annual reports between August 2004 and December 2004 and found that the aggregate level of satisfactory disclosure was 84% for the whole market and 93% for the top 500 listed entities.

1.6 ASX's effectiveness in supervising the market is reflected also in ASIC's annual assessment of ASX's licence obligations and our ranking internationally as a well supervised market.

1.7 Each year ASX is assessed by ASIC as to how well ASX complies with its licence obligations. Successive reports have found that ASX continues to function as an effective and reliable market. In its most recent assessment published on 19 July 2005, ASIC concluded that ASX has adequate arrangements for supervising its markets, including arrangements for handling conflicts between its commercial and supervisory responsibilities, for monitoring the conduct of participants in the market, and for enforcing compliance with the Rules. ASIC particularly commended ASX's work on corporate governance with the ASX Corporate Governance Council.

1.8 ASIC noted in its report that none of the suggestions it made for improvements detracts from its overall unqualified conclusion that ASX's arrangements had met and continue to meet ASX's statutory obligations.

1.9 In October 2005, ASIC also released an "issues free" assessment of ASX's clearing and settlement arrangements. This assessment found that ASX Settlement and Transfer Corporation Pty Limited (ASTC) and Australian Clearing House Pty Limited (ACH) have adequate arrangements for supervising its respective clearing and settlement facility. The assessment also found that management and staff demonstrated a high level of operational expertise and that both ASTC and ACH used "good and reliable technology" to remain "active and vigilant in their financial risk management". The systematic support provided by ASTC and ACH for ASX's markets is critical to their success and they play a key role in the national economy.

1.10 At an international level, the regulation of securities exchanges in Australia was ranked number three in the world, ahead of major markets such as the US, Germany and Japan by the 2004/05 Global Competitiveness Report (produced by the World Economic Forum). The Report measured market transparency, independence from executive government influences and effectiveness of exchange rules within 104 countries. ASX is looked upon by other exchanges in our region as a model for supervising markets.

Section 2: Supervision Review outcomes

2.1 As part of a renewed vigour to improve in everything we do, ASX has completed its broad strategic review (the Supervision Review) of its supervisory roles (both policy and supervision). This followed closely on the heels of ASX's review of its commercial operations through the "Profit and Loss Drivers Review". The Supervision Review reinforced the link between supervision and market integrity with the success and confidence of our market.

2.2 The Supervision Review concluded that ASX is committed to retaining its supervisory role. Both ASIC and Government want ASX to stay in the supervisory space and the Parliamentary Secretary to the Treasurer, Mr Chris Pearce, has said that the system is working well. There is also widespread support from participants and listed companies for ASX to retain its supervisory role.

2.3 Notwithstanding ASX's existing reputation for the supervision of our markets, the Supervision Review has identified further improvements to strengthen confidence in our markets, and at the same time minimise the costs of compliance and in doing so keeping the costs of capital low.

Section 3: Additional improvements to maintain and strengthen market integrity

3.1 Two of the key improvements ASX is making to strengthen market integrity relate to ASX's detection of insider trading and its contribution to corporate governance.

Insider Trading

3.2 ASX has in place sophisticated technology (eg the SMARTS trading alert system) and procedures to assist in the early detection of potential breaches of our insider trading laws and other forms of market manipulation. This is supported by ASX's continuous disclosure regime. In addition, ASX works closely with ASIC to provide ongoing assistance with its insider trading investigations. ASX has referred 68 potential issues concerning insider trading laws to ASIC over the last three financial years. While this has worked well to date, with the increased market activity, additional resources will be added.

3.3 To strengthen ASX's role as a front line detector of insider trading activity and build on the work we are currently doing in this area, a more dedicated specialist insider trading unit will be established. This additional resource will enhance ASX's ability to be even more proactive in identifying potential insider trading practices and further improve the ongoing assistance it provides to ASIC with its investigations. This unit will be appropriately staffed and additional technology resources will be added to assist in detecting insider trading activities, including further enhancements to the SMARTS alert system, a non-trading surveillance system to provide improved search and "non-trading" alerts and a risk-based assessment system to better facilitate the supervision of participants. These additional resources will enable ASX to better examine potential insider trading activities and provide relevant information more quickly to ASIC to assist its investigations.

Corporate Governance

3.4 ASX has played a leading role in corporate governance since the formation of the ASX Corporate Governance Council in August 2002.

3.5 Whilst the current regime is working well, ASX is committed to further improving corporate governance disclosure with the addition of more resources.

3.6 ASX will continue to chair the Council and has added further resources to provide a full-time secretariat for the chair and additional support for the ad hoc working groups of the Council. More resources will also be deployed for monitoring, enforcement and education of corporate governance disclosures.

3.7 Among the issues currently being examined by the ASX Corporate Governance Council are:

a. Review of the principles and recommendations to remove duplication with other regulators such as ASIC and APRA.

b. Reporting requirements for smaller listed companies – whether they can be made simpler.

c. The extent to which the principles should embody sustainability reporting (eg, environmental matters). The Council currently is considering a request from Senator Ian Campbell (Minister for the Environment) to develop a view on corporate sustainability reporting.

Regulatory Policy Unit

3.8 A new Regulatory Policy Unit (RPU) has been established to separate regulatory policy from the supervision or enforcement of the Operating Rules and other rules or policies. Established in October 2005, the RPU allows ASX to respond quickly to market dynamics that may require a change to the Operating Rules.

3.9 The RPU reports directly to the CEO of ASX and the ASX Board and is responsible for:

- Development of ASX rules policy
- Responding to Government papers
- Rules amendments policy; and
- Streamlining operating rules

3.10 The RPU will obtain input on policy matters through a consultative process involving the Market Supervision and Markets divisions and Legal unit of ASX, industry, Government/Treasury and ASIC.

3.11 The establishment of the RPU ensures that the ASX Board receives advice on the direction of policy matters in a similar way as, for example, Treasury assists the Federal Treasurer. Day to day supervision of the Operating Rules remains with Market Supervision in a similar way, for instance, as enforcement of the Corporations Act remains with ASIC. Policy set by the ASX Board will continue to be reviewed and approved by ASIC and the Treasurer.

3.12 To illustrate with an example, where a regulatory initiative arises (eg. bookbuilds) that requires a policy position to be determined by ASX, the RPU would consult with Market Supervision to obtain input on supervisory issues, consult with the Markets Division of ASX and industry to obtain input on industry practice, review relevant practices in overseas markets and consult with ASX Legal and ASIC to prepare a draft consultation paper. After receiving further information through consultation the RPU would make a recommendation on ASX's policy position and put the matter to the ASX Board for decision. The ultimate policy formulated by the ASX Board would be reflected in relevant Rules and submitted to ASIC and the Minister for approval. The relevant Rules would then be monitored and enforced by Market Supervision.

Additional Resources to further improve Supervision

3.13 Additional resources are to be provided to continue to further improve supervision of listed entities and market participants. These resources include technological and systems enhancements such as:

- A risk-based assessment system to improve compliance targeting, make on-site reviews more efficient and introduce electronic delivery of participant self-assessment programs to replace paper based processes
- Provision of an on-line application process for new Participants to replace the existing paper-based systems
- A new system to provide improved search and non-trading alerts for surveillance activities, and
- Electronic straight through processing of regulatory related company announcements, forms and reports.

3.14 Additional resources also will be provided for staff training and development to ensure ASX supervisory personnel continue to keep abreast of relevant industry developments and business practices, and improve their compliance investigation techniques and other related skills.

Section 4: Additional improvements to minimise/reduce costs of Compliance

Improvement to Operating Rules

4.1 The Supervision Review has identified a number of areas within the ASX Operating Rules where there is overlap between the Rules and the Corporations Act, and between the regulatory activities of ASX and ASIC. Also identified is the need to clarify the application of certain Rules and the exercise of ASX discretions. Such overlap and lack of clarity is a burden on listed entities and market participants and adds unnecessary levels of complexity and "red tape" which in turn increases compliance costs and adds to the cost of capital.

4.2 Given the Federal Government's establishment on 12 October 2005 of a Regulation Taskforce to identify practical options for alleviating the compliance burden from government regulation, it is timely that the Supervision Review also has identified the need to reduce the compliance burden on participants and listed entities by undertaking a rewrite of ASX's Operating Rules.

4.3 ASX will rewrite its Operating Rules with the guiding principle of introducing more principles-based rules that maintain and strengthen market integrity but at the same time reduce complexity, overlap between the Rules and the Corporations Act, and the costs of compliance. In addition, ASX will adopt principles (such as sunset clauses, removal of non-operating rules and so on) to ensure that the rules remain up-to-date, simple and carry a minimum of compliance costs.

4.4 The Supervision Review has identified five specific initiatives to undertake in this regard. They are:

(i) The desirability of discretions and, where necessary, the development of new Guidance Notes to clarify the discretions ASX has under specific rules. These Notes will clarify the circumstances in which these discretions may be exercised. Where appropriate, ASX will consult with industry and ASIC in reviewing existing discretions and developing new Guidance Notes.

The project will take approximately six months to complete.

(ii) Identify and, where appropriate, remove the areas of overlap between the Listing Rules and the Corporations Act (eg: rules relating to periodic reporting and transactions with persons of influence). The purpose of this project is to reduce unnecessary duplication between ASX responsibilities and ASIC responsibilities. Again, ASX will consult with ASIC, Treasury and industry (as appropriate) in developing rule amendments.

The project will also take approximately six months to complete.

(iii) Identify and, where appropriate, remove the areas of overlap between the Market Rules and the Corporations Act (eg: reporting by participants of breaches of Australian Financial Services Licence obligations). The purpose of this project is to remove the dual compliance burden on Market Participants under the Rules and the Corporations Act. This project also will involve consultation with ASIC, Treasury and industry (as appropriate) in developing rule amendments.

The project should take six to nine months to complete.

(iv) A review with ASIC of the respective responsibilities of ASX and ASIC in regulating the broker-client relationship so that the Market Rules are better aligned with the Corporations Act and reduce duplication. The main purpose of this project will be to establish a more effective regime for the monitoring of the broker-client relationship.

This project will take 12 to 18 months to complete.

(v) A complete rewrite of the Market Rules to identify and clarify ASX's supervisory role and develop a sound underlying conceptual framework for the regulation of Market Participants. This project will involve more clearly articulating the policy basis of existing rules and identifying gaps in the existing rule framework.

The project is expected to take 18 to 24 months to complete.

Internal reorganisation of Market Supervision

4.5 In July 2005 ASX announced that it would reorganise the internal structure of the Market Supervision Division to more closely align operations with the needs of the market to improve efficiency and productivity and to add resources where needed. The new internal structure came into effect on 1 October this year. Market Supervision now has three core supervisory units - Issuers; Participants and Enforcement. The new structure will improve the communication and transparency between ASX and listed entities and market participants on supervisory issues, and improve communication and co-operation with ASIC on regulatory matters.

Other efficiency and productivity measures

4.6 Two other internal improvements put in place to improve efficiencies and productivity, and remove administrative duplication, are the introduction of performance measures for all ASX staff and a series of continuous improvement projects for each unit within Market Supervision.

4.7 The performance measures introduced are short-term incentives (cash, not share based) for all staff, long-term incentives (cash, not share based) for General Managers and the Group Executive Market Supervision and a prohibition on trading in ASX shares for all supervision staff. Each staff member's work performance will be assessed each year against the performance objectives set with them at the beginning of the year. Payment of the incentives will be determined by reference to achievements against the objectives. These performance measures are aligned to the Business Plans for Market Supervision and aimed at further improving supervision and ASX's reputation for outstanding supervision for the integrity of our Markets.

Section 5: Improvements to strengthen confidence and ASX's handling of conflicts of interest

5.1 ASX goes to considerable lengths to manage potential conflicts between its commercial and supervisory interests. Many other corporates like banks and law firms also face this business issue. The measures currently in place to manage conflicts are working well and include:

(i) ASX (as a listed company) does not supervise itself – it is supervised by ASIC

(ii) Physical and procedural structures separate commercial activities from supervisory activities, quarantine supervision decision-making and prevent any suggestion of improper influence by the commercial areas of ASX on supervisory decisions.

(iii) Internal oversight at three levels by:

(a) ASX Supervisory Review Pty Limited, an independent subsidiary company tasked with reviewing and reporting to the ASX Board on compliance by ASX with its statutory licence obligations, and overseeing certain supervisory decisions involving Review Group Entities and Review Participants.

(b) Group Compliance, an internal unit tasked to develop, review and test regulatory-related policies and procedures especially conflicts.

(c) Board Committees such as the Audit & Risk Committee and Market Rules Committee which review supervisory related matters

(iv) Ongoing external oversight by ASIC involving ASX lodging an annual compliance report with ASIC and the Minister and an annual assessment and report from ASIC on ASX's compliance with statutory licence obligations, including how ASX handles conflicts.

5.2 These measures (outlined in 5.1) will all remain in place.

5.3 The ASX Board recognises that it is in ASX's long-term business interests to ensure that it manages potential conflicts so that confidence in the markets is enhanced even more. To enhance this confidence, the following additional measures will be introduced:

(i) The operational supervisory functions will be placed in a separate subsidiary. The three core elements of the Market Supervision Division – Issuers, Participants and Enforcement will be placed into a separate subsidiary company which will oversee supervisory and enforcement operations relating to the Operating Rules. Supervision will continue to report to the Chief Supervision Officer (CSO) (currently Group Executive Market Supervision) but the CSO will report to a separate subsidiary board and not to the CEO of ASX. All supervisory decisions will be made by the CSO which, in effect, confirms the existing practice where the Group Executive Market Supervision is responsible for making all operational supervisory decisions.

(ii) The CSO reporting directly to the subsidiary board enhances independence for operational matters and will further assist in removing the perception of conflicts between ASX's commercial and supervisory activities.

(iii) The new subsidiary company will have a Chairman and directors drawn equally from the ASX Board and elsewhere. The CSO will continue to chair the ASX Corporate Governance Council and the internal and external oversight currently provided by ASIC, ASXSR and Group Compliance will continue.

(iv) The responsibility for the administration of the peer review and appeal tribunals (the Disciplinary Tribunals) also will be transferred to the subsidiary company.

5.4 A comparative review of the governance structure of other exchanges shows that there is a trend towards the establishment of more arm's length arrangements to deal with the perception of conflict of interest. These vary but what ASX has now is regarded as one of the best. The enhancements will keep us ahead. It is in line with where other markets (like NYSE) are headed.

Section 6: Funding of Improvements

6.1 ASX will continue to fund supervision (and the subsidiary company). To ensure that the perception of conflicts is minimised and to provide greater transparency of the costs of the supervisory activities and associated cost structures, the CSO will operate under a three year rolling budget and be subject to similar disciplines on efficiency, productivity and requests for additional funding as are imposed by government on other regulatory bodies like ASIC, ACCC and APRA. In this way, the CSO will always have the ability to ask for additional funding to ensure adequate arrangements are in place to supervise markets and satisfy ASX's licence obligations on having adequate financial, technological and human resources.

6.2 The costs of supervision will be funded by ASX. Where additional investment is needed, and made, ASX will pass these on in increased listing fees.

6.3 These increases are very much to handle immediate investment needs. In the longer-term, productivity and efficiency measures and other measures outlined above aimed at reducing compliance costs will reduce pressure for fee increases and may in fact enable a fee reduction by passing on these savings back to customers.

6.4 The total estimated costs of the improvements identified from the Supervision Review over and above Supervision's current (2005/06) expense budget is approximately $10m over the next 3 years as set out below.

Costs	2006/07	2007/08	2008/09	Total
Capital	$3.525m	$1.375m	-	$4.9m
Recurring	$2.887m	$1.497m	$1.141m	$5.525m
Total	$6.412m	$2.872m	$1.141m	$10.425m

The capital component has been budgeted to be absorbed within ASX's current capital expenditure budget. Recurring items will be passed through increases to annual listing fees to apply from 1 July 2006.

Section 7: Implementation

7.2 Many of the improvements coming out of the Supervision Review have already been put in place or commenced. They are the new internal structure for Market Supervision, establishment of the new Regulatory Policy Unit, additional resources for corporate governance, the rewrite and simplification of ASX's Operating Rules, new performance measures for all staff, and the continuous improvement initiatives to drive efficiency and remove duplication of internal processes.

7.2 The specialist insider trading unit will be established from 1 March 2006 and the new subsidiary structure will be fully operational from 1 July 2006. These improvements may be refined further with the benefit of consultation and input from ASIC, Treasury, Government and industry (where appropriate), and any further decisions will be made by the ASX Board in March 2006.

Section 8: Conclusion

8.1 For Australia to remain an attractive place to raise capital it is important that both listed entities seeking funds and investors looking to trade can participate on our markets with confidence. This confidence is underpinned by market integrity.

8.2 The outcomes from the Supervision Review will generate improvements to ASX's ability to carry out its supervisory role. The investment in additional resources for insider trading, corporate governance and systems technology will further improve ASX supervision and allow it to maintain and strengthen market integrity. So too will the measures to improve efficiency and productivity such as the internal reorganisation of Market Supervision, the rewrite of the ASX Operating Rules, the performance measures for supervision staff and the continuous improvement initiatives. Each of these should also help minimise the costs of compliance for ASX customers.

8.3 The shifting of supervision (supervisory operations) into a subsidiary company and the separation of regulatory policy from supervision will further reduce the perception of conflicts between supervision and commercial areas of ASX. It will, together with the new funding arrangements, also provide greater independence and transparency for the operational supervisory functions, which in turn will result in greater confidence in our capital markets.