

January 2021

ASX 24

Obligations Review 2020

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Contents

Executive summary	4
Purpose of this report	4
Conclusion	4
ASX 24	5
Overview	5
ASX 24's licence	5
ASX Group and ASX Compliance	6
Findings	7
ASIC's oversight of ASX 24	7
Matters arising during the review period	7
ASX 24's compliance with its licence conditions	8
Conclusion	8
Appendix: How we conducted our review	10
Our role	10
Market operator obligations	10
Approach	10
Information reviewed	11

Executive summary

Purpose of this report

Australian Securities Exchange Limited (**ASX 24**) is licensed to operate the ASX 24 derivatives market (**derivatives market**) in New Zealand. The FMA is required to report at least once every two years¹ on how well ASX 24 is meeting its licensed market operator obligations.² This review covers the period 1 July 2018 to 30 June 2020. This is our third review of ASX 24 since its licence came into effect on 1 December 2014.

The Australian Securities and Investments Commission (**ASIC**) is ASX 24's primary regulator. We therefore focused our review on whether ASIC was satisfied with ASX 24's compliance during the review period. See the Appendix for details about how we carried out our review.

Conclusion

We are satisfied that, during the review period, ASX 24:

- ensured, to the extent reasonably practicable, that its licensed market was fair, orderly and transparent
- had adequate arrangements for notifying disclosures from participants in its market, and for continuing to make them available
- had adequate arrangements for handling conflicts between its commercial interests, and the obligation to ensure its market operates in a fair, orderly and transparent manner
- had adequate arrangements for monitoring the conduct of participants in its markets
- had adequate arrangements for enforcing compliance with market rules
- had sufficient resources (including financial, technological and human resources) to operate its licensed market properly.

Our conclusion is based largely on ASIC's oversight of ASX 24 and its view of ASX 24's compliance, including previous assessments relevant to the operation of ASX 24 carried out under the Australian Corporations Act 2001 (**Corporations Act**).

ASIC has said that it has no reason to believe that ASX 24 was not compliant with its market operator obligations under the Corporations Act during the review period.

Monitoring the conduct of participants means monitoring all persons trading on licensed markets, including authorised participant firms and their clients. This would generally include surveillance of trading activity. Under the Corporations Act, ASX 24 must monitor and enforce compliance with its operating rules, which govern the behaviour of its participant firms; while ASIC has responsibility for real-time market surveillance. We are satisfied this provides appropriate supervision of the conduct of all participants in the derivatives market.

See the 'Findings' section of this report for details.

¹ A condition of ASX 24's licence is a review every two years. The licence is available on our website [here](#).

² A market operator's full obligations are set out in the Appendix.

ASX 24

Overview

ASX 24 operates the derivatives market. Products traded on the market include futures and options on indices, interest rates and energy.

In the year ended 30 June 2020, approximately 169 million futures and options on futures contracts were exchanged on the derivatives market.³

ASX 24 is part of the ASX Group, which also operates the ASX securities market (**securities market**), and provides market services such as clearing and settlement.

ASX 24's licence

ASX 24 was an authorised futures exchange under the Securities Markets Act 1988. Under the transitional provisions of the FMC Act, it was deemed to hold a financial product market licence from 1 December 2014. The conditions of ASX 24's licence were largely carried over from the authorised futures exchange notice. ASX 24's licence can be viewed on our website.⁴

ASX 24's home jurisdiction is Australia, and ASIC is the primary regulator of its market operations. Its market operator obligations in Australia are contained in the Corporations Act. It is also subject to the ASIC Market Integrity Rules (Futures Market) 2017,⁵ ASIC Market Integrity Rules (Securities Markets and Futures Markets) Amendment 2018 (No. 1), and ASIC Market Integrity Rules (Futures Markets – Capital) 2017 (together **Market Integrity Rules**).

A condition of ASX 24's FMC Act licence is that New Zealand investors must be informed that ASX 24 is regulated primarily under Australian law.

ASX 24 is required to give the FMA half-yearly information about trading participants who offer derivatives in New Zealand through the derivatives market.

As at 30 June 2020, 19 trading participants were authorised to transact New Zealand derivatives on the derivatives market. We do not require ASX 24 to monitor or report on the extent of trading in New Zealand derivatives by these participants, or the extent of trading by New Zealand investors.

ASX 24 must also notify us if it intends to make any material changes to the rules for the derivatives market. Rule changes must be approved by ASIC and the Australian Minister for Revenue and Financial Services.

³ ASX Limited Annual Report 2020

⁴ <http://fma.govt.nz/assets/Market-Operators-Licences/ASX-Ltd-Financial-Product-Market-Licence-2014.pdf>

⁵ Previously ASIC Market Integrity Rules (ASX 24 Market) 2010.

ASX Group and ASX Compliance

The ASX Group includes two licensed market operators and four licensed clearing and settlement systems. The group also includes ASX Compliance Limited (**ASX Compliance**).

ASX Compliance is responsible for overseeing compliance by listed entities with the ASX listing rules and by participants with the operating rules of the various markets and clearing and settlement facilities operated by the ASX Group. It has delegated authority to make certain compliance and enforcement decisions on behalf of the ASX Group licensees.

ASX Compliance is comprised of three functional units:

- Listing compliance
- Participants compliance
- Executive Office, which administers:
 - Enforcement action against participants and listed entities,
 - ASX Corporate Governance Council, and
 - ASX Compliance Education and Research program.

This means that most of ASX 24's policies, procedures, systems, governance, and other arrangements that satisfy its market operator obligations, are designed and administered by ASX Group. Examples include:

- financial, technological and human resources for all licensed entities are managed at a group level
- Market Operations, which includes trading operations, surveillance and the market announcements office, carries out those services for both licensed markets
- ASX Compliance is responsible for managing conflicts for listed entities and participants, and for monitoring and enforcing the rules of both the derivatives and securities markets.

Findings

As ASIC is ASX 24's primary regulator, our review focused on whether ASIC was satisfied with ASX 24's compliance during the review period. We have, however, also considered reports and information relevant to the operation of the ASX 24 derivatives market, including but not limited to group licence reports.

ASIC's oversight of ASX 24

ASX Group must report to ASIC each year on whether it has complied with all of its market operator obligations for both the derivatives and securities markets.

ASIC can elect to assess at any time whether ASX Group complies with any or all of its market operator obligations. This allows ASIC to monitor the group's market operator arrangements on a risk basis. It also allows ASIC to target compliance reviews against specific obligations, based on its risk assessments.

To help identify risks, ASIC has introduced a standard quarterly report for ASX Group to complete. These reports give ASIC a significant amount of data about all areas of the group's operations on a regular basis. This quarterly reporting also forms part of the group's annual self-assessment of its compliance.

If ASIC has concerns or queries about market operations, either from this quarterly reporting, its own monitoring activities, or other sources of information such as complaints, it raises matters with ASX Group as necessary.

ASIC's risk-based monitoring helps to determine if more detailed reviews are necessary. During this review period, ASIC did not undertake any detailed review or report into ASX 24's operations. ASIC did review and report on ASX Group's arrangements for exchange traded AQUA products.⁶ In this review, ASIC found that ASX Group had met the relevant obligations.

Matters arising during the review period

Changes to market operating rules

During the review period, ASX introduced a number of amendments to ASX 24 Market Rules and ASX 24 Market Rule Procedures,⁷ to facilitate improvements to various aspects of the ASX 24 market in accordance with maintaining a fair, orderly and transparent market.

Industry consultation

During the period under review, ASX 24 undertook various industry consultations with respect to their product offering.⁸ These consultations resulted in improvements to the ASX 24 product offering for the benefit of the market.

⁶ The report is available at <https://asic.gov.au/regulatory-resources/find-a-document/reports/rep-644-assessment-of-asx-s-arrangements-for-exchange-traded-aqua-products/>

⁷ <https://www2.asx.com.au/about/regulation/rules-guidance-notes-and-waivers/recent-rule-amendments>

⁸ [90 Day Bank Accepted Bill Futures Contract](#) (Jan 2019), [ASX 24 Bond Futures Roll Consultation](#) (Oct 2019); [ASX 24 Bond Futures Roll Consultation Feedback Report](#) (Feb 2020)

For example, the BAB contract is now cash settled, rather than physically delivered, while a number of enhancements have been made to improve the efficiency of the Bond Roll, which is an ongoing area of interest for ASIC.

Matters arising after the review period

Technology disruptions

Subsequent to the review period, on Monday 16 November 2020, ASX Group experienced technology disruptions which caused the securities market to close for the day. While this did not impact the ASX 24 derivatives market, as part of ongoing monitoring, ASIC will be monitoring closely the technology resources dedicated to service the ASX 24 market. These matters may also be the subject of comment in our next obligations review for the period ending 30 June 2022.

ASX 24's compliance with its licence conditions

Under ASX 24's licence,⁹ ASX 24 is required to provide a compliance report to the FMA every second financial year. The report is due with the FMA within three months of ASX 24's financial year-end.

In our previous review, we noted that ASX 24 did not provide the report by the required deadline. In our discussions with ASX 24 at the time, they informed us that they were currently remapping their key compliance obligations, which would be automated following the introduction of a new Governance, Risk and Compliance (GRC) application.

With the implementation of the GRC application pending, ASX 24 has introduced additional controls to manage reporting requirements.

This year, ASX 24 did not provide the report by the required deadline. In this instance, the report was delayed by nine business days. The compliance report provided to us is the same report provided to ASIC under the Corporations Act, and the delay occurred to allow ASX 24 to meet with ASIC to finalise the report before providing it to the FMA. ASX 24 confirmed that they expected to provide the compliance report to the FMA before the required deadline.

We acknowledge that ASX 24 has submitted on time the required half-yearly information reports for this review period, regarding trading participants who offer derivatives in New Zealand through the derivatives market.

Given that ASX 24 has met other reporting obligations, the limited duration of and the reason for the delay, and that ASIC do not have specific concerns about its compliance, we do not consider that this warrants regulatory action. We may reconsider this approach in future, however, if similar conduct is repeated.

Conclusion

Other than the aforementioned delay in providing its compliance report, we are satisfied that ASX 24 complied with the market operator obligations under the FMC Act during the review period.

The reasons are:

- ASIC's risk-based monitoring has not led to reviews of ASX 24's compliance with any of its obligations

⁹ At clause 12 of the licence

- ASIC has said it has no reason to believe that ASX 24 was not compliant with its market operator obligations under the Corporations Act during the review period
- FMA has not received any complaints about the operation of the ASX 24 derivatives market in New Zealand
- ASX Group General Licence Review reports gave us no reason to believe that ASX 24 was not compliant in all material respects with regard to its market operator obligations.

Appendix: How we conducted our review

Our role

Under the FMC Act, we are required to periodically review how well a licensed market operator is meeting its obligations, and to publish a written report.

Market operator obligations

In the FMC Act, 'market operator obligations' means:

- the general obligations contained in section 314 of the FMC Act:
 - to ensure, to the extent reasonably practicable, that each of the licensed markets is fair, orderly and transparent
 - to have adequate arrangements for notifying disclosures from participants in its markets, and for continuing to make them available
 - to have adequate arrangements for handling conflicts between its commercial interests and the obligation to ensure its markets operate in a fair, orderly and transparent manner
 - to have adequate arrangements for monitoring the conduct of participants in its markets
 - to have adequate arrangements for enforcing compliance with market rules
 - to have sufficient resources (including financial, technological and human resources) to operate its licensed markets properly
- an obligation to respond to any request from us to make changes to market rules (section 333)
- an obligation to provide us with an annual self-assessment of how it complies with its obligations (section 337)
- an obligation to act on our, or the Minister's,¹⁰ direction if it has failed to meet any of its obligations (sections 340 to 342)
- any obligation imposed as a condition of a market operator's licence.

Approach

A market operator that is authorised and regulated in an overseas country may be licensed under the FMC Act if certain conditions are met.

A key requirement is that the home jurisdiction responsible for regulating and supervising the market operator should provide a level of investor protection and market integrity that is comparable to the FMC Act.¹¹ This allows us to rely on the overseas regulator to assess and monitor the capability and compliance of the market operator.

¹⁰ New Zealand Minister for Commerce and Consumer Affairs

¹¹ The original authorisation of ASX 24 as a futures exchange was assessed under a similar requirement in the repealed Securities Markets Act 1988. ASX 24 was deemed to have a licence from 1 Dec 2014 as it moved to the FMC Act regime.

ASX 24's market operator obligations in the Corporations Act are largely equivalent to its FMC Act obligations. ASX 24 does not have an obligation in Australia to carry out surveillance of real-time trading activity. This function has been carried out by ASIC since 2010.

ASX 24 must report to ASIC annually on how it complies with its market operator obligations. ASIC may assess, at any time, how well ASX 24 is complying with any or all of the obligations. These provisions are also equivalent to those in the FMC Act.

Information reviewed

Our review included liaising with ASIC about:

- its ongoing oversight of ASX 24
- any matters or concerns raised with ASX 24 during the review period
- how ASX 24 addressed those matters; and
- ASIC's overall view of ASX 24's compliance with its market operator obligations.

We also looked at the following:

- Reports provided by ASX 24 on its compliance with its obligations for the years ended 30 June 2019 and 2020 (as required under section 337 of the FMC Act). These were the same reports ASX provided to ASIC under the Corporations Act
- Information on the ASX website about how ASX meets its market operator obligations for both the securities and derivatives markets. This included:
 - how ASX interprets its obligation to operate fair, orderly and transparent markets
 - how ASX meets its obligation to have adequate arrangements for monitoring and enforcing compliance with the operating rules of its markets
 - how ASX meets its obligation to manage conflicts between commercial and regulatory interests, and a summary of its conflict-handling arrangements
 - the ASX Compliance board charter, which sets out the roles and responsibilities of ASX Compliance
- Past reports by ASIC on ASX's compliance with its market operator obligations.¹²

¹² These reports are available on ASIC's website at <https://asic.gov.au/regulatory-resources/markets/market-structure/licensed-market-and-clearing-and-settlement-facility-assessment-reports/>