



**ASIC**

Australian Securities & Investments Commission

**REPORT 380**

# **Market assessment report: NSX Group**

**National Stock Exchange of Australia Limited  
ACN 000 902 063**

**SIM Venture Securities Exchange Ltd  
ACN 087 708 898**

December 2013

## **About this report**

This report relates to the period 9 March 2012 to 1 July 2013 (assessment period) and also comments on the sufficiency of NSX Group's financial resources from the end of the assessment period to December 2013.

### About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

**Consultation papers:** seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

**Regulatory guides:** give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

**Information sheets:** provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

**Reports:** describe ASIC compliance or relief activity or the results of a research project.

### Previous NSX Group assessment reports

The Stock Exchange of Newcastle Limited was granted an Australian market licence under the transitional provisions (s1413) of the Corporations Act on 8 March 2002. The market licence was varied with effect from 31 March 2004 and again from 20 December 2006, the latter variation including recognition of the change of name of the licensee to National Stock Exchange of Australia Limited (NSXA).

Bendigo Stock Exchange Limited (BSX) was approved as a stock exchange under s769(1) of the Corporations Law on 6 October 2000. BSX subsequently was granted a market licence under the transitional provisions (s1413) of the Corporations Act, effective from 8 March 2002. The licence was varied with effect from 13 May 2004 and again from 23 June 2010. The latter variation recognised the change of name of the licensee to SIM Venture Securities Exchange Ltd (SIM VSE).

Report number	Report date
REP 326	February 2013
REP 260	October 2011
REP 206	June 2010
REP 175	November 2009

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## A Summary of observations and conclusions

### Key points

ASIC may conduct assessments of market licensees, such as the National Stock Exchange of Australia Limited (NSXA) and SIM Venture Exchange Ltd (SIM VSE) (collectively NSX Group) under s794C of the *Corporations Act 2001* (Corporations Act).

At the time of the assessment, the scope of our assessment was required to include the obligations in s792A(c), which require the licensee to have adequate arrangements for operating the market properly, including adequate arrangements to handle conflicts of interest and monitor and enforce the operating rules. We can also include other Ch 7 obligations. In keeping with our standard practice, we extended the scope of our assessment to include a review of whether NSX Group had sufficient financial, technological and human resources to properly operate its licensed markets' facilities: see s792A(d).

We use the licensee's self-assessment reports, information from our previous assessments, our observation of the licensee's performance, market intelligence and other things to form a view of how well the licensee has operated its market.

ASIC's recent annual assessments of NSXA and SIM VSE have publicly highlighted observations about the financial position of NSX Limited (the holding company of both market licensees), in respect of whether there is sufficient funding available to operate the markets and comply with the relevant obligations under Corporations Act. In our most recent assessment report, published in February 2013 (*Report 326 Market assessment report: NSX Group (REP 326)*), ASIC noted that NSX Group's financial position had continued to deteriorate and that without a significant improvement in the short term, there was a material risk that NSX Group would not meet its obligation to have sufficient financial resources in future assessments.

NSX Group undertook a capital raising in April 2013 and put in place other measures intended to support its financial position. ASIC considers that the current financial position of NSX Group is such that, under existing circumstances, there remains a material risk that NSXA and SIM VSE will not have sufficient financial resources to operate their markets properly in future assessment periods. We have made certain recommendations in this regard: see Section B.

Our assessment also included observations in respect of NSXA and SIM VSE's obligation during the assessment period to have adequate conflict handling arrangements: see s792A(c)(i). We have made recommendations that will better support compliance in future assessments.

There are five recommendations and/or agreed actions that focus on aspects of NSX Group's activities.

## The assessment

### ASIC's obligations

- 1 Under s794C(1) of the Corporations Act, ASIC may assess how well a market licensee is complying with its obligations under s792A(c), and other obligations under Ch 7, specifically s792A(d).

### Licensee's obligations

- 2 In our assessment we reviewed whether NSX Group has adequate arrangements for operating its markets under s792A(c). This includes its two licensees' (NSXA and SIM VSE) arrangements for handling conflicts and its arrangements for monitoring and enforcing compliance with the relevant market's operating rules.
- 3 Under s794C(1), we are permitted to extend the scope of our assessment to review how well a market licensee complies with any or all of its obligations under Ch 7 of the Corporations Act. In keeping with our standard practice, we extended the scope of our assessment to include a review of whether NSX Group had sufficient financial, technological and human resources to properly operate its licensed markets: see s792A(d).

### Assessment period

- 4 Our assessment covers the period from 9 March 2012 to 1 July 2013 and this report also comments on the sufficiency of NSX Group's financial resources from the end of the assessment period to December 2013.

## Our approach to assessments

### ASIC's strategic priorities

- 5 ASIC's current strategic framework focuses on three key strategic priorities or outcomes. These are to ensure:
- fair and efficient financial markets;
  - confident and informed investors and financial consumers; and
  - efficient registration and licensing.
- 6 The first two of these are particularly important for licensed markets. For example, appropriate resourcing is fundamental to ensuring that markets operate in an efficient manner. The adequate management and transparency of matters such as conflict handling arrangements are important to the fairness of the market. Similarly, the effective monitoring and enforcement

by a market operator of its continuous disclosure requirements is critical in ensuring that investors and consumers are confident and make informed decisions. For these reasons, we regard the assessment process as an important tool by which we continue to strive to meet our strategic outcomes.

## Guiding principles

- 7 Our assessments are guided by certain principles that draw on the International Organization of Securities Commissions' (IOSCO) Objectives and Principles of Securities Regulation. The principles we use to guide assessments are:
- admission standards for issuers and participants are robust and administered in a fair and transparent way;
  - post-admission standards are robust, effectively monitored, and enforced in a fair and transparent manner;
  - operating rules promote transparency to market users of material price and trading information;
  - the deterrence of unfair trading practices is supported by robust arrangements for detection and prompt referral to ASIC of significant contraventions of the Corporations Act and ASIC market integrity rules (and notification to ASIC of licensee's enforcement action to address significant breaches of markets' operating rules where these breaches do not involve contraventions that ASIC has the power to act on);
  - conflicts are adequately handled; and
  - sufficient resources (including technological resources) are deployed to operate the market in a proper and reliable manner.

## Methodology

- 8 In conducting our assessment, we:
- held discussions with senior NSX Group personnel;
  - reviewed internal NSX Group documentation obtained under notices issued under s30 of the *Australian Securities and Investments Commission Act 2001*;
  - reviewed the 2012 annual regulatory report given to ASIC by NSXA and SIM VSE, as required under s792F;
  - considered information received from and about NSX Group licensees in the ordinary course of ASIC's dealings with them as market licensees;
  - considered information from external sources, including media and industry commentary; and
  - reviewed the operation of the market throughout the assessment period.

## Focus areas for this assessment

- 9 For this assessment, in considering NSX Group's compliance with its statutory obligations, we paid particular attention to:
- the sufficiency of NSX Group's human and financial resources devoted to operating its markets;
  - the operation of NSX Group's conflict handling arrangements—in particular, to ensure that there are adequate arrangements for handling conflicts of interest between its commercial interests and the need to ensure the markets operate in a fair, orderly and transparent manner;
  - NSX Group's framework for admitting participants to its market facilities;
  - NSX Group's approach to monitoring compliance with its licence obligations; and
  - the sufficiency of NSX Group's technological resources and IT security to effectively operate its market.

## Nature of licence obligations

- 10 A licensee's obligations are ongoing and whether it is likely to comply with these obligations in the future cannot be judged merely by reference to its past compliance.
- 11 We therefore use the assessment process to:
- reach conclusions about the adequacy of the arrangements a market licensee has in place in accordance with its obligations at the time of the assessment; and
  - identify issues, which in our view need, or may need, to be addressed to ensure ongoing compliance.
- 12 Since 1 August 2010, when responsibility for frontline supervision of certain NSXA and SIM VSE operating rules was transferred to ASIC, ASIC has supervised market participants' compliance with the ASIC Market Integrity Rules (NSXA Market) 2010 and ASIC Market Integrity Rules (SIM VSE Market) 2010. These market integrity rules are based on rules previously contained in the NSXA and SIM VSE market operating rules that predominantly dealt with matters such as participant conduct and participant–client relations. The NSX Group licensees continue to monitor and supervise the capital adequacy of NSXA and SIM VSE participants.
- 13 From 1 August 2010, s792A(c) was amended in recognition of these new arrangements. From this date, a market licensee (such as NSXA and SIM VSE) is required to have adequate arrangements for 'operating' (rather than 'supervising') its market. This still includes the requirement that a market

licensee must have adequate arrangements for monitoring and enforcing compliance with its remaining operating rules (particularly its listing rules), and still includes the requirement to handle conflicts of interest.

- 14 More broadly, a market licensee retains:
- the overarching obligation to do all things necessary to ensure that its market operates, to the extent reasonably practicable to do so, in a manner that is fair, orderly and transparent; and
  - the same responsibilities in the critical area of its listing functions and in respect of its frontline supervision of compliance with the listing rules.

### **Adequate arrangements**

- 15 In assessing how well a licensee is complying with its statutory obligations to have adequate arrangements in place to operate its market and monitor its market participants' compliance with its operating rules, we consider whether a licensee has adequate arrangements to monitor and enforce its operating rules, and to handle conflicts of interest.

### **Arrangements for monitoring and enforcing compliance with operating rules**

- 16 In determining whether a licensee is complying with its obligations to monitor and enforce its operating rules, we consider how the licensee:
- deals with listed entities and monitors disclosure to detect potential or actual non-compliance with the law or the market's operating rules;
  - monitors trading and participant activity in relation to its operating rules to detect potential or actual non-compliance with the law or the market's operating rules;
  - plans and documents procedures for ensuring frequent and comprehensive assessment of its ongoing compliance with its obligations, and ongoing compliance by listed entities and market participants with their obligations;
  - deals with actual or suspected breaches of the law or the operating rules, including remedial, disciplinary and other deterrent measures;
  - deals with complaints about the market or market participants; and
  - shares information with ASIC and (where appropriate) operators of other markets and clearing and settlement facilities.

### **Arrangements for handling conflicts of interest**

- 17 In assessing the adequacy of a licensee's arrangements for handling conflicts of interest, it is relevant that the regulatory regime does not preclude the existence of conflicts. NSX Group must, however, handle any conflicts it



does have so as not to allow its commercial interests to prevail over its obligation to operate a market that is fair, orderly and transparent.

- 18 Conflicts of interest may arise in any area where a market licensee makes decisions with respect to monitoring and enforcing its operating rules. For example, conflicts of interest may arise in connection with decisions about:
- admission of a person to the market as either a participant, nominated adviser or a listed entity;
  - monitoring of a listed entity or market participant;
  - investigative or disciplinary action against participants, listed entities or listed entities' directors (as provided for under NSXA's listing rules);
  - the exercise of discretions, such as granting waivers from the market's operating rules; or
  - the determination of the fees schedule of a financial market, including any trading incentive programs and/or relevant stakeholder rebates.
- 19 In assessing a market licensee's arrangements for handling conflicts of interest, we consider a range of matters, including:
- whether, under current arrangements, actual or potential conflicts of interest are reliably anticipated, identified and appropriately responded to;
  - whether there is a sufficient level of disclosure to the market about the nature and existence of any actual or perceived conflict and the steps taken to adequately manage it; and
  - whether the licensee's organisational and reporting structures separate its commercial activities from its monitoring activities to a significant degree.
- 20 For example, a suitable organisational and reporting structure is one where employees who are responsible for assessing the market licensee's compliance with its monitoring obligations report to a person who is not responsible for making commercial decisions.

### **Sufficient resources**

- 21 In assessing how well a licensee is complying with its obligation to have sufficient resources to properly operate the market under s792A(d), we consider:
- how the licensee makes available and uses resources to support its arrangements for operating the market, taking into consideration:
    - the financial, technological and human resources made available compared with previous assessment periods; and
    - a general expectation that resourcing should increase in step with the licensees' operations and that any reduction is appropriate only

where changed circumstances or specific efficiencies can be clearly demonstrated;

- the licensee's information technology system 'uptime' and instances of market disruption; and
- our own experiences and observations, as well as those of market users, that there can be confidence that the market will operate in a reliable manner.

## Assessment findings

- 22 ASIC's recent annual assessments of NSXA and SIM VSE have publicly highlighted observations about the financial position of NSX Limited, in respect of the holding company of both market licensees having sufficient funding available to enable NSX Group to operate the markets properly and comply with the relevant obligations under the Corporations Act. In REP 326, ASIC noted that NSX Group's financial position had continued to deteriorate, and that without a significant improvement in the short term there was a material risk that NSX Group will not meet its obligation to have sufficient financial resources in future assessments.
- 23 NSX Group undertook a capital raising in April 2013 and put in place other measures to support its financial position for this assessment period. ASIC considers that the current financial position of NSX Group is such that, under existing circumstances, there remains a material risk that NSXA and SIM VSE will not have sufficient financial resources to operate their markets properly in future assessment periods. We have made certain recommendations in this regard: see Section B.
- 24 In our recent annual assessments of NSXA and SIM VSE we have also made observations and recommendations about improvements to conflict handling arrangements. In Report 260 *Market assessment report: NSX Group* (REP 260), we raised a number of concerns on how conflicts of interest were being managed by the market licensees. In REP 326, ASIC raised a number of further concerns in relation to conflicts handling arrangements.
- 25 In this assessment period, ASIC has observed an example of where it considers that the circumstances of the particular matter demanded a greater adherence to the management of actual or perceived conflicts than was demonstrated in that case.

## Recommendations and agreed actions

- 26 ASIC makes five recommendations and agreed actions for NSX Group licensees, some of which relate to the matters set out above.
- 27 Our recommendations and agreed actions for NSX Group can be found in Section B of this report.

## Market conditions

- 28 During 2012 and 2013, NSX Group averaged approximately 15 trades per day. At the commencement of the assessment period, NSXA had 18 registered participants and that number has since increased by nine. SIM VSE had six participants and that number has since increased by five.<sup>1</sup>
- 29 NSXA has a total of 64 entities admitted to its Official List (eight of which are suspended) and 122 securities issued by those entities quoted on the market. Approximately 60% of the listed entities have a market capitalisation of \$5 million or less. Two listed entities have a market capitalisation of greater than \$160 million. SIM VSE has three listed entities admitted to its Official List and four securities issued by those entities quoted on the market.<sup>2</sup>

## Consultation

- 30 NSX Group has had the opportunity to view and comment on the factual accuracy of this report. Where appropriate, this report reflects NSX Group's comments.

## Ongoing areas of consideration

- 31 The primary area of focus continues to be NSX Limited's financial position, in respect of having sufficient financial resources to operate the markets properly. Considerable ongoing focus is also given to the adequacy of NSX Group's arrangements to handle conflicts of interest.
- 32 Openmarket Online Trading Pty Ltd (OMOT) is an entity that has been identified by NSX Group as a review party.<sup>3</sup> OMOT owns Openmarkets Australia Limited (formerly known as Cameron Stockbrokers Limited, an existing NSXA market participant). Openmarkets Australia Limited was

<sup>1</sup> NSX Limited, *Quarterly activities report and appendix 4 cashflow statement*, 23 October 2013.

<sup>2</sup> Figures provided by NSX Group on 1 August 2013.

<sup>3</sup> NSXA, *Disclosures of conflicts of interest*, May 2013.

suspended from acting as a market participant following ownership and operational transition, and pending completion of application requirements to recommence trading.

- 33 During the assessment period, ASIC was advised that NSXA will follow much of the new participant process for the re-activation of Openmarkets Australia Limited as a market participant of NSXA. Openmarkets Australia Limited was reactivated as a market participant of NSXA, and has recently been approved as a broker participant of SIM VSE.
- 34 ASIC considers that compliance with participant process is important for any market operator, particularly where there is a potential for conflicts of interest. ASIC will consider whether to review all decisions made by NSXA regarding the re-activation of Openmarkets Australia Limited as a participant of NSXA, and the approval of Openmarkets Australia Limited as a broker participant of SIM VSE.
- 35 On the basis that continuous disclosure remains the keystone of market integrity, we will continue to discuss with NSX Group the process of ensuring its guidance is in keeping with industry best practice.

## B Our recommendations and agreed action

### Key points

We have considered the adequacy of NSX Group's arrangements and resources for the operation of its markets.

ASIC's recent annual assessments of NSX Group have publicly highlighted observations about the financial position of NSX Limited, the holding company of both financial markets licensees in respect of whether there is sufficient funding available to operate the markets properly and comply with the relevant obligations under the Corporations Act. In REP 326, ASIC noted that NSX Group's financial position had continued to deteriorate, and that without a significant improvement in the short term there was a material risk that NSX Group would not meet its obligation to have sufficient financial resources in future assessments.

NSX Group undertook a capital raising in April 2013 and put in place other measures intended to support its financial position for this assessment period. ASIC considers that the current financial position of NSX Group is such that, under existing circumstances, there remains a material risk that NSXA and SIM VSE will not have sufficient financial resources to operate their markets properly in future assessment periods. We have made certain recommendations in this regard: see paragraph 46.

Our assessment also included observations in respect of NSXA and SIM VSE's obligation during the assessment period to have adequate conflict handling arrangements: see s792A(c)(i).

We have made five recommendations and/or agreed actions for NSX Group where we believe further action is warranted, some of these relate to the matters described above. These relate to NSX Group licensees':

- financial resources;
- obligations to ensure they have adequate arrangements for handling conflicts between their commercial interests and the need for them to ensure that their markets operate in a fair, orderly and transparent manner;
- obligations to monitor and enforce compliance with their operating rules; and
- technology resources, IT resources and technology security.

### Nature of recommendations and agreed action

- 36 Our recommendations for the assessment period can be broken down into four categories:
- *financial resources*—NSX Group licensees' obligation to have sufficient financial resources to properly operate their markets (Recommendation 1);

- *conflict handling*—NSX Group licensees’ ongoing obligation to ensure that they have adequate arrangements for handling conflicts between their commercial interests and the need to ensure that their markets operate in a fair, orderly and transparent manner (Recommendation 2);
- *monitoring and enforcing compliance*—NSX Group licensees’ obligation to have adequate arrangements for monitoring and enforcing compliance with their operating rules (Recommendations 3–4); and
- *technology assessment*—NSX Group licensees’ obligation to have sufficient technology resources, IT systems and process to properly operate their markets (Agreed action 1).

## Financial resources

- 37 In our recent annual assessments of NSXA and SIM VSE, we highlighted observations about the financial position of NSX Limited, the holding company of both market licensees in respect of having sufficient funding available to operate the markets and comply with the relevant obligations under the Corporations Act.
- 38 In REP 260, which was made public in October 2011, ASIC concluded that NSX Group had sufficient resources to operate its markets properly for at least two years. In REP 326, we noted that NSX Group’s financial position had further deteriorated and that without a significant improvement in the short term, there was a material risk that NSX Group would not meet its obligation to have sufficient financial resources for future assessments.
- 39 In Note 33 to the audited annual financial report of NSX Limited released to the market on 29 August 2013 (‘the recent audited accounts’), the following is stated:
- The company has incurred losses of \$1,961,995 for the year ended 30 June 2013. In addition to this the company’s current cash burn rate indicates that the company may not have sufficient working capital to meet its operational obligations for the coming 12 months.
- The Directors have noted that the ongoing ability of the company to remain a going concern is dependent upon an increase in the level of working capital within the company. The Directors have instigated and are investigating the following strategies in an attempt to increase the level of working capital:
- Execution of a Funding Guarantee Deed with Financial and Energy Exchange, on 29 July 2013, to providing minimum working capital of \$220,000 per month (as required);
  - Continuing to leverage the remaining contribution due from FEX for the SIM VSE joint venture;
  - Investigate share placements to private investors; and/or

- Instigation of the Company's wind down procedures, which would see the cash deposits held in trust being realised and all liabilities extinguished. At the completion of the wind-down procedures, the Directors believe excess cash would exist over expected cost of wind-down.

40 In the independent auditors report attached to the recent audited accounts, the following is stated:

Emphasis of Matter

Without modifying our opinion, we draw attention to Note 33 in the financial report, which indicates that the company incurred a net loss of \$1,961,995 during the year ended 30 June 2013, and, as of that date, the company's current liabilities exceeded its available working capital. A number of strategies ensure the Economic Entity remains a going concern have been developed by the Directors as set forth in Note 33.

Should the Economic Entity not be able to achieve these strategies or receive the required level of financial support, there exists a material uncertainty that may cast significant doubt about the Economic Entity's ability to discharge its liabilities in the normal course of business.

41 NSX Limited undertook a capital raising in April 2013. The capital raising was undersubscribed. The NSX Limited board determined that the capital raising was not sufficient for the funding of the operations of the company. Consequently, NSX Limited negotiated and entered into a Funding Guarantee Deed with Financial and Energy Exchange Limited (FEX) on 29 July 2013. The Funding Guarantee Deed allows FEX to fund the operations of the company as and when NSX Limited needs to draw on those funds. On 11 December 2013, NSX Limited announced to the market that, as at that date, it had received \$400,000 from FEX pursuant to the Funding Guarantee Deed.

42 On 23 October 2012, it was announced to the market that NSX Group's cash balance was \$1,354,000. In the recent audited accounts, NSX Limited's annual operating cash outflow is stated as \$1,741,243, averaging \$145,103 per month.

43 On 23 October 2013, NSX Limited released the *Quarterly activities report and appendix 4C cashflow statement*, for the period ending 30 September 2013. As at 30 September 2013, the cash balance of NSX Limited had deteriorated to \$234,000. As at 30 September 2013, NSX Limited's quarterly operating cash outflow was \$231,000, averaging \$77,000 per month. As NSX does not generate adequate operating cash flow, it is dependent on outside funding to meet its financial obligations.

44 ASIC considers that the current financial position of NSX Group is such that, under existing circumstances, there is a material risk that NSXA and SIM VSE will not have sufficient financial resources to operate their markets properly in future assessment periods.

45 For ASIC to be satisfied in this regard we would need written confirmation, as soon as practicable, from NSXA and SIM VSE that they have, and will continue to have, unconditional access to an amount equal to the projected

total cash outflow of the market licensees for six months, on a rolling basis. This includes providing projections of cash flows for NSXA and SIM VSE for the next six months, the calculations and assumptions used for preparing the projections, and, on a monthly basis, providing updated projections of cash flows covering the following six months.

- 46 We note that the current terms of the Funding Guarantee Deed between NSX Limited and FEX provide for either party to terminate the arrangement by giving one month's notice. An approach NSX Limited could take in the short term, and by 1 January 2014 at the latest, is to have that notice of termination period amended to a six-month period. On that basis, the Funding Guarantee Deed would, in practice, provide for FEX to fund NSX Limited's operating costs with monthly instalments for a minimum of six months.

#### **Recommendation 1: NSX Group to confirm access to an amount equivalent to six months of cash outflows**

We recommend that, as soon as practicable, NSX Group provide to ASIC written confirmation of continuing unconditional access to an amount equal to the projected total cash outflow of the market licensees for six months, on a rolling basis. An approach NSX Limited could take in the short term, and by 1 January 2014 at the latest, is to have that notice of termination period in the Funding Guarantee Deed amended from one month to six months.

## **Conflicts handling**

- 47 The second category of recommendations relate to NSX Group licensees' ongoing obligation to ensure that they have adequate arrangements for handling conflicts between their commercial interests and their obligation to ensure that their markets operate in a fair, orderly and transparent manner.
- 48 In REP 260, ASIC raised a number of concerns relating to how conflicts of interest were being handled by the market licensees within NSX Group. At that time, a decision made by the Listing and Admissions Committee to reject a listing application was reviewed by the NSX Limited board and overturned. A month later the NSX Limited board admitted a second entity to the official list on the basis that the Listing and Admissions Committee was unable to form a quorum to consider the matter within the applicant's preferred timeframe. Both of the entities were listed on the NSXA with conditions imposed by the NSX Limited board on the listing.
- 49 In consideration of these matters, and as discussed in REP 260, both ASIC and the licensees agreed that the board will have no future operational involvement in the supervision of its licensee markets. The board charter states that the supervisory role of the board is confined to setting and reviewing policy. The charter also states that the board retains overall



responsibility for approval of recommendations from the Compliance Committee, Audit Committee, Nominations Committee, Remuneration Committee and Listing and Admissions Committee.

- 50 Under NSX Group's existing conflict handling arrangements, operational decisions that may be unduly influenced by the licensees' commercial interests are referred to two NSX Group committees—the Listing and Admissions Committee and the Compliance Committee. Specifically, decisions in respect of admission and conditions for admission for listed entities are delegated to the Listing and Admissions Committee. Any appeals from these decisions are determined by the Compliance Committee.
- 51 In REP 326, ASIC raised a number of further concerns in relation to conflict handling arrangements, including the need for NSX Group to ensure that a person is charged with monitoring how those arrangements operate in practice, and the need for review of the remuneration policies of NSX Group that are linked to listing applications.
- 52 Our focus this year was to review how these conflict management arrangements operate in practice in relation to entities with which NSX Group has an inherent conflict (real or perceived). In particular, and as foreshadowed in REP 326, ASIC reviewed the decisions that were made in relation to the removal of a number of listing conditions of two entities listed on NSXA: see paragraph 48.
- 53 Based on the documentation reviewed, in May 2012, one of the two entities listed on NSXA applied to have four listing conditions removed. The matter was considered by the Listing and Admissions Committee, which agreed to remove two of the conditions. The other two conditions were retained by the Listing and Admissions Committee. The Listing and Admissions Committee also determined that it would review the remaining conditions after a further 12 month period.
- 54 In June 2012, the two entities made separate applications to the NSX Limited board for the removal of the remaining listing conditions. The matter was appropriately referred to the Listing and Admissions Committee for consideration and determination.
- 55 Before the Listing and Admissions Committee met to consider the matter, the NSX Limited board wrote a letter to the Listing and Admissions Committee setting out its views and position on the matter. NSX Limited has presented the view that it was appropriate for the board to write the letter because of the importance of ensuring that the Listing and Admissions Committee was aware of the facts behind the NSX Limited board's decision to originally impose the conditions. NSX Limited has also presented the view that information provided by the board was not operational in nature, but related to policy.

- 56 ASIC's assessment of the correspondence is that the letter went further than providing a simple factual account of the rationale behind the original reasons for the imposition of the conditions. ASIC's assessment of the letter is that it provided a clear view of the position of the NSX Limited board to the Listing and Admissions Committee that the majority of the conditions could be removed. On reviewing the letter, certain NSX Group staff also highlighted to the members of the NSX Limited board the view that the NSX Group board letter was inconsistent with the positions agreed in REP 260 in relation to the board not having any operational role in, or otherwise influencing, pending supervisory decisions.
- 57 ASIC notes observations in previous assessments relating to conflict handling arrangements and, in particular, how those arrangements were applied in relation to the entities referred to in paragraph 48. In this context, ASIC considers that there was a heightened importance of ensuring that supervisory decisions taken by NSX Group in respect of those entities were undertaken with a particular focus on the management of real or perceived conflicts.
- 58 Given this sensitivity, ASIC considers that the NSX Group board should have more carefully adhered to the content and spirit of its own published policies and handling procedures, which required separation of the board from operational involvement in pending supervisory decisions.
- 59 With a view to better supporting compliance in future assessment periods, ASIC recommends NSX Group implement more refined conflict handling processes and practices to ensure the separation of the board from pending supervisory decisions, particularly for decisions where there is heightened importance for management of real or perceived conflicts of interests.
- 60 NSX should report on the implementation of the processes and practices by 31 January 2014. ASIC recommends that the implementation of the processes and practices include provision of details of appropriate training for officers and employees of NSX Group.
- 61 ASIC will review the processes and may, if appropriate, make further recommendations for NSX Group to engage a suitably qualified independent third party, approved by ASIC, to conduct an audit of the adequacy of NSX Group's conflict handling arrangements.

**Recommendation 2: Implementation of refined conflict handling processes and practices, and potential future recommendation for external third-party audit.**

ASIC recommends NSX Group implement more refined conflict handling processes and practices to ensure the separation of the board from pending supervisory decisions, particularly for decisions where the management of real or perceived conflict is of heightened importance. The processes and practices should include details of appropriate training for

officers and employees of NSX Group. NSX Group should report on the implementation of the processes and practices by 31 January 2014.

Upon review of the report ASIC may, if appropriate, make further recommendations for the appointment of a suitably qualified independent third party, approved by ASIC, to conduct an audit of the adequacy of NSX Group's conflict handling arrangements.

## Monitoring and enforcing compliance

- 62 The third category of recommendations and agreed actions relates to NSX Group's obligation to have adequate arrangements for monitoring and enforcing compliance with its operating and listing rules. Our focus was on reviewing NSX Group's processes for supervision of its market in relation to listed entities' disclosure of price sensitive information to the market.
- 63 NSXA has the rule infrastructure to permit independent NSX Group Compliance Committee disciplinary hearings, including for breaches of its continuous disclosure rules. For example, in September 2012 the NSX Group Compliance Committee censured a responsible entity of a listed managed fund, in relation to a breach of NSXA listing rules dealing with fundraising disclosure. The practical consequence of censures is that fund managers' mandates often prevent them investing in censured entities. In this sense, censures can be more powerful than fines.

### Listed entity fundraising disclosure

- 64 ASIC reviewed NSX Group's practices in supervising its market in response to disclosure by listed entities of price-sensitive information where the entity is preparing to undertake on-market fundraisings, particularly when the relevant entity was previously suspended.
- 65 NSXA's listing rules allow for the use of an information memorandum (IM) in limited circumstances, including disclosure of matters set out in Appendix 1 of the listing rules. The standard of disclosure in Appendix 1 is lower than that required of a prospectus under s710 of the Corporations Act.
- 66 To ensure that all material information is made available to the market to enable informed decision making, ASIC considers that where a company is seeking readmission to quotation after a long period of suspension, it may be appropriate that the company be required to make a disclosure equivalent to a s710 prospectus level disclosure, where an IM is permitted.
- 67 While NSXA has a 'Policy on Suitability for Listing—NSX Markets', the policy does not address how NSXA may exercise its discretion regarding the readmission to quotation of a suspended company. ASIC recommends that NSX Group develop more refined policies and procedures in respect of how

NSXA exercises its discretion in terms of the form and level of disclosure required for readmission to quotation of a company, particularly in circumstances where the company has been suspended for a period of time.

### Recommendation 3: Review of listed entity fundraising disclosure policies and procedures

ASIC recommends that NSX Group develop more refined policies and procedures in respect of how NSXA exercises its discretion in terms of the form and level of disclosure required for readmission to quotation of a company, particularly in circumstances where the company has been suspended for a period of time.

## Supervision and admission of market participants

- 68 ASIC reviewed NSX Group's practices in relation to supervision and admission of market participants. The focus of the review assessed:
- the admission process for NSX Group's market participants; and
  - NSX Group's annual review of its market participants and their compliance with the NSXA Operating Rules.
- 69 NSX Group's admissions process consists of reviewing the market participant's application, documentation requests, interviews with representatives of the market participant, and a final documented submission to the Listing and Admissions Committee for consideration of admission.
- 70 NSX Group's supervisory activities focus on whether market participants are complying with the NSXA operating rules. This involves requiring all market participants to complete an annual questionnaire, on-site visits which include the review of documents, and interviewing representatives of the market participant.
- 71 ASIC reviewed NSX Group's documentation and record-keeping processes of the application process and on-going assessment of market participant's compliance. Our review observed the following relevant documentation was not contained in market participant's files:
- file notes of interviews conducted by NSX Group with applicant representatives;
  - records of the work completed as part of the on-site reviews of participants;
  - records of compliance issues or potential breaches that were identified as part of the self-assessment and on-site reviews; and
  - records of how decisions were made in response to breaches or compliance issues that were classified as 'not significant' by NSX Group.

- 72 ASIC was subsequently informed that some of these documents did exist, however the documents were stored in locations that were not easily accessible by NSX Group staff.
- 73 In addition, ASIC also reviewed submissions to the relevant committees. We note that the following relevant information was not submitted to the relevant committees:
- *admission process*—when interviews were undertaken as part of the nomination of responsible officers, the Listing and Admissions Committee was not informed about results of the interviews; and
  - *on-site reviews*—when reports were submitted to the Compliance Committee, the reports contained limited information about breaches or compliance issues identified, and how they were dealt with.
- 74 To ensure that NSX Group staff and the relevant committees are able to make fully informed decisions, we consider that all relevant information should be made available to appropriate parties, including Committee members. To facilitate the provision of this information, ASIC recommends that the relevant information be kept in a location that is easily accessible by those parties.

#### Recommendation 4: Accessibility of relevant information

ASIC recommends that NSX Group make available all relevant information to appropriate parties, including Committee members, by storing this information in a location that is easily accessible.

## Technology assessment

- 75 The final category of recommendations relates to NSX Group's obligation to have adequate technology and IT resources in place to operate an efficient, transparent and orderly market.
- 76 Our assessment involved reviewing:
- NSX Group's IT service management arrangements and software licence and maintenance agreements, including service level agreements for the trading system;
  - contracts with other exchanges for the provision of trading system functions;
  - measures put in place to ensure that confidentiality of NSX Group data, and the data of other exchanges, are protected; and
  - NSX Group's preparedness against cyber attacks.

## **NSX Group's technology agreements**

- 77 Software licence and maintenance agreements for NSX Group's X-stream Trading system were supplied to ASIC for review.
- 78 The software licence and maintenance agreements specify service levels which are defined contractually with NOMX. NSX Group's reports state that NSX Group provides level 1 support and rarely escalates technical support issues to NOMX. NSX Group has stated that they are satisfied with the response time provided by NOMX.
- 79 The NSX Group trading platform is a mature and stable product which is used widely in markets around the world.
- 80 ASIC reviewed the software licence and maintenance agreement between NSX Group and NOMX to ensure that confidentiality was addressed, and that the appropriate service level agreements were in place to ensure immediate rectification of production system problems. In particular, issues caused by defects and potential cyber security breaches.
- 81 ASIC considers that the software licence and maintenance agreement is adequate, and the appropriate service level agreements are in place.

## **Agreement with South Pacific Stock Exchange**

- 82 ASIC reviewed the contract between NSX Group and South Pacific Stock Exchange (SPSE), to which NSX Group provides outsourcing services for the X-stream Trading system.
- 83 ASIC believes that the appropriate agreements are in place for technical support to be provided, and that confidentiality is addressed in the contract.
- 84 NSX Group provides frontline support to SPSE and escalates issues which they cannot solve to NOMX under their service level agreement. NSX Group has confirmed they are satisfied with the service level agreement between NSX Group and NOMX for the provision of the X-stream Trading system application support to SPSE.

## **Confidentiality measures**

- 85 NSX Group outsources NOMX's X-stream Trading system to SPSE in Fiji.
- 86 ASIC notes the X-stream Trading system supports the appropriate application-level user role security to prevent users from modifying data. Access to the system can be limited to specific board users who are authorised for access. In addition, LAN and server operating system security further minimises unauthorised access by staff of any exchange to modify trading system data.

87 ASIC believes the application security available is adequate in relation to protecting changes to NSX Group data from unauthorised NSX or SPSE users.

### **NSX Group's preparedness against cyber attacks**

88 ASIC reviewed NSX Group's approach to cyber attack preparedness. ASIC reviewed the system security documentation provided by NSX Group.

89 ASIC notes that NSX Group has implemented a cyber security strategy for its hardware, software and firewalls, as well as policies and procedures to mitigate intrusion.

90 In order to confirm the adequacy of NSX Group's preparedness against cyber attacks, the cyber security strategy and its implementation should be reviewed at least annually by NSX technical staff, and a report of the review should be provided to ASIC.

91 NSX agrees that it will continue to monitor the security of its markets, perform testing of its infrastructure (as it sees appropriate), and employ an independent third-party consultant if the board of NSX considers it necessary.

#### **Agreed Action 1: A security review to be undertaken at least annually.**

NSX Group has agreed to conduct security reviews at least once a year. All reviews are to be provided to ASIC.

## C Agreed actions from previous assessment

### Key points

In February 2013, we published REP 326, which included three agreed actions and four recommendations. NSX Group took steps to comply with these agreed actions and recommendations.

92 Table 1 lists NSX Group's progress against each agreed action and recommendation arising from our previous assessment.

**Table 1: Recommendations and agreed actions from the previous assessment of NSX Group**

Recommendations and agreed actions	Status
<b>Recommendation 1: NSX Group to provide monthly updates of its financial situation</b>	
ASIC recommended that, from February 2013, NSX Group provide ASIC with monthly updates of its financial position, signed by two directors.	NSX Group provided to ASIC the monthly updates signed by two directors.
<b>Agreed action 1: Remuneration policies to be amended</b>	
NSX Group agreed to review their remuneration and conflict of interest policies to ensure that conflicts of interest arising from remuneration of staff are adequately managed.	NSX Group advised ASIC on 21 August 2013 that the NSX board has abolished bonuses linked to application fees to supervisory staff for successful listing applications.
<b>Agreed action 2: All relevant information for a pending supervisory decision to be provided to all committee members</b>	
NSX Group agreed that papers making a recommendation on listing and/or waiver applications should contain all of the relevant information to allow the relevant committee to make an informed decision.  They have also agreed that papers distributed to all committee members before their meetings should record pre-meeting discussions between the NSX Group staff who are involved in assessing applications and making recommendations and members of the committees in relation to any pending formal applications. Decisions reached before committee meetings should be itemised and disclosed to the committees as a whole. These records should be retained on NSXA and SIM VSE files.  NSX Group's policies and procedures will be amended to reinforce this.	We confirmed with the Listing and Admissions Committee that papers they received now record pre-meeting discussions and that pending supervisory decisions are now made by the committee as a whole on the papers before them.  NSX Group notes this has recently been updated in the procedures and policies.



Recommendations and agreed actions	Status
<b>Agreed action 3: Conflicts of interest to be expressly identified when they arise</b>	
<p>NSX Group agreed to amend their procedures for managing conflicts of interest to make it an express requirement that if a conflict of interest is present this will be identified in the recommendation paper provided either to the Listing and Admissions Committee and/or the Compliance Committee.</p>	<p>We note that NSX Group has identified 'material holdings' by parties deemed to be a conflict of interest in reports to the Listing and Admissions Committee and/or Compliance Committee. In addition, amendments to procedures for managing conflicts of interest have been sent to ASIC. ASIC considers all interests should be identified.</p>
<p>NSX Group also agreed that the Compliance Officer will be required to review all Listing and Admissions Committee decisions to ensure that formal policies have been followed and that the decisions were not subject to any bias or undue influence. The Compliance Officer will provide a six-monthly report to the board to this effect.</p>	<p>NSX Group has advised that the first six-monthly report for the period January to June 2013 was completed.</p>
<b>Agreed action 4: Conflicts of interest policies and procedures</b>	
<p>NSX Group agreed to:</p> <ul style="list-style-type: none"> <li>• update their conflicts of interest policies and procedures documents by 28 February 2013, providing a copy in draft to ASIC for our review before finalisation;</li> <li>• ensure that a person is in charge with monitoring how these arrangements operate in practice. This person will report annually to the NSXA and SIM VSE boards on whether decisions of the Listing and Admissions Committee are in accordance with conflicts policies and procedures and that the policies and procedures are fit for purpose; and</li> <li>• ensure that the NSXA and SIM VSE boards each continue to include at least one independent director and that independence of that director is continuously reviewed by the boards.</li> </ul>	<p>We note that the conflict of interest policy has been updated on the NSX Group website, and a copy of the updated conflict of interest policy and procedures was provided to ASIC.</p> <p>In progress, the first annual report is due for completion in January 2014.</p> <p>The NSX and SIM VSE boards have had at least one independent director since October 2011.</p>

Recommendations and agreed actions	Status
<p>In the interests of increasing transparency of the NSX Group markets and fostering investor confidence in those markets, NSXA and SIM VSE agreed to publish on their websites:</p> <ul style="list-style-type: none"> <li>• all updated conflict of interest policy documents (existing policy is already published to websites);</li> <li>• a list of review parties, and those entities admitted to their Official List, in which: <ul style="list-style-type: none"> <li>○ NSX Group directors hold the office of director or officer; and</li> <li>○ FEX and its related entities, or directors of NSX Limited, NSXA and SIM VSE, have a material shareholding or are a material creditor; and</li> </ul> </li> <li>• the names of the entities with which the NSX Group has a commercial relationship and that relationship is such that it may give rise to material actual or potential conflicts, the nature of the conflict, and the arrangements that it has in place to manage the conflict, should be elaborated on the websites.</li> </ul>	<p>We note that the conflict of interest policy has been updated on the NSX Group website.</p> <p>We note that the list of review parties have been published on the NSX Group website.</p>
<b>Recommendation 2: Review of disclosure policy</b>	
<p>ASIC recommended that NSX Group reviews its current policies, particularly NSXA practice note 6, to ensure they remain current and in keeping with best practice standards, taking account observations in paragraph 66 of REP 326. ASIC also recommended that NSX Group create internal procedures to ensure that listed entities are required to respond to a price query in a timely manner and that the revised policy is actively enforced.</p>	<p>NSX Group provided ASIC with an updated draft guidance note.</p>
<b>Recommendation 3: Development of additional continuous disclosure policy</b>	
<p>ASIC recommended NSXA guidance to its listed entities on the application of its continuous disclosure listing rules should reflect close adherence to standards applied in all other Australian licensed markets.</p> <p>ASIC also recommended NSX Group consider amending its NSXA practice note 6 as set out in paragraph 69 of REP 326 and ensure active enforcement of those areas.</p> <p>ASIC also recommended NSX Group update its published continuous disclosure policy documents and update ASIC as to progress by 28 February 2013.</p>	<p>NSX Group provided ASIC with an updated draft guidance note.</p>

## Key terms

Term	Meaning in this document
ASIC	Australian Securities and Investments Commission
ASIC Market Integrity Rules (NSXA) 2010	Rules made by ASIC under s798G of the Corporations Act for trading on NSXA
ASIC Market Integrity Rules (SIM VSE) 2010	Rules made by ASIC under s798G of the Corporations Act for trading on SIM VSE
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
BSX	Bendigo Stock Exchange
Ch 7 (for example)	A chapter in the Corporations Act (in this example numbered 7)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
FEX	Financial and Energy Exchange Limited
IOSCO	International Organization of Securities Commissions
NSXA	National Stock Exchange of Australia Limited, or the exchange market operated by NSXA
NSX Group	NSXA and SIM VSE
SIM VSE	SIM Venture Securities Exchange Ltd, or the exchange market operated by SIM VSE
s794C (for example)	A section of the Corporations Act (in this example numbered 794C), unless otherwise specified