



16 August 2019

Andrew McPherson  
Senior Manager  
Market Infrastructure  
Australian Securities and Investments Commission  
Level 5, 100 Market Street  
Sydney NSW 2000

By email: [rules.resilience@asic.gov.au](mailto:rules.resilience@asic.gov.au)

Dear Andrew

**ASIC Consultation Paper 314 on Market Integrity Rules for technological and operational resilience**

Chi-X Australia Pty Ltd (**Chi-X**) is grateful for the opportunity of providing a submission in response to CP 314 on Market Integrity Rules for technological and operational resilience.

Chi-X is also grateful that ASIC has taken a more concise approach to this issue than that found in Regulation SCI.

Chi-X notes a primary purpose of the paper is to enhance ASIC's enforcement toolkit with respect to entities like Chi-X, but would also support ASIC, market operators, participants and wider stakeholders working together to deliver clear standards in this area that enhance Australia's markets.

This submission is segmented as follows:

1. Existing Regulatory Obligations;
2. Lack of Certainty on What is Required and the Breadth of the Definitions
3. Global Standards
4. Strict Liability
5. Next steps
6. **Attachment One:** Answers to the CP Questions.



## 1. Existing Regulatory Obligations

Chi-X is of the view that the rules legislate detailed tasks that are aimed at delivering outcomes already required of market operators under the existing regulatory framework. It is not clear from the text of the CP that the existing framework would, if it were appropriately monitored and enforced, fail to satisfactorily deliver those outcomes.

The net outcome of the rules may therefore be the legislative mandating of detailed tasks for no net benefit in outcomes. Chi-X accepts that ASIC may be in the best position to make the final decisions on these issues, but is of the view that it is important not to legislate additional detailed tasks without there being a clear need to do so.

## 2. Lack of Certainty on What is Required and the Breadth of the Definitions

Two issues that permeate much of the proposed rule framework are:

- (a) Certainty of application: There is a lack of certainty on how to interpret and apply the rules. This is problematic on several fronts:
- (i) The lack of certainty may in fact frustrate ASIC prosecutions for contraventions as the provisions may not be sufficiently clear and certain to enable sanctions for a contravention to be imposed. Enforcement provisions should be clear and precise to enable those targeted to clearly understand what is required to avoid sanction. The possible interpretations of the rules and definitions cover such a broad range of outcomes in circumstances where the correct interpretation is not clear. This may thwart the prosecution of a contravention and therefore put at risk one of the main reasons for the CP reforms.
  - (ii) Operators and participants may not know precisely what is required of them and so are at risk of:
    - well-intentioned conduct that gives rise to inadvertent non-compliance;
    - an excessive and wasteful allocation of resources to attain supra-equivalent standards;
    - being subject to the pressures associated with ensuring no competitive advantage is obtained by competitors taking an interpretation of the rules that results in lower standards.
- (b) Breadth of the definitions and rule applications: The potential breadth of the definitions may result in the framework imposing obligations on systems that should not be subject to the detailed requirements in the rules. For example, the ASIC market surveillance systems are caught by the definition and so ASIC would be required to deal bilaterally with multiple licenced entities seeking to ensure ASIC met the standards required of critical systems.

Further, the cascade of definitions from critical system to outsourcing services, will result in a regulatory 'fiction' of making many third party services 'outsourcing services', even though they are in fact normal third party vendor relationships. This fiction may require licenced firms to impose the



standards of regulated firms on unregulated entities. Chi-X is not certain that this outcome is appropriate on a cost-benefit analysis or other basis. Chi-X notes below the different approach of MiFID and the FCA to defining outsourced services.

### **3. Global Standards**

Chi-X is of the view that some features of global regimes may be appropriately incorporated into the Australian framework including:

- (a) the tiered approach of Regulation SCI which targets primary listing functions differently to those of an ATS;
- (b) the link between outsourcing services and regulated services, for the purpose of imposing requirements on regulated firms in respect of those outsourcing services, that is found in the MiFID Organisation Regulation (eg see the definition of 'services' in article 2) and rule 8.1.1(1) of the Senior Arrangement, Systems and Controls Sourcebook of the FCA);
- (c) the exemptions for standardised services that is found in chapter 8 of the Senior arrangement, Systems and Controls Sourcebook of the FCA; and
- (d) the proportionate approach that is found in article 32 of the General Data Protection Regulation (GDPR).

### **4. Strict Liability**

Chi-X queries the appropriateness of what is in effect a strict liability offence in the areas of data confidentiality and security. Chi-X is of the view that it may be more appropriate to take the proportionate approach in article 32 of the GDPR.

### **5. Next Steps**

Chi-X would welcome the opportunity to work with ASIC, other operators, participants and stakeholders, to deliver a clearer and more certain regime for critical systems. A goal of that regime could be to mandate easily determined and well understood standards of conduct of the regulated community that are necessary to enhance Australia's markets, protect investors and enable well intentioned firms to achieve those standards and avoid sanction.

I hope this submission is of assistance in your important work in this area, please do not hesitate to contact us if you have any queries.

Yours sincerely

Chi-X Australia Pty Ltd

**ATTACHMENT ONE - TABLE OF ANSWERS**

CP Number	Question	Chi-X Response
<b>B1Q1</b>	<p>Do you agree with the definition of ‘critical systems’ and ‘critical systems arrangements’? In your response, please give detailed reasons for your answer.</p> <p>‘critical system’ to mean functions, infrastructure, processes or systems which in the event of failure to operate effectively, would or would be likely to cause significant disruption to the market operator’s or market participant’s market-related operations and services</p>	<p>The definition is principles based and will extend to many functions, infrastructure, systems or processes that, on their face, are not intended to be caught by the rules.</p> <p>The breadth of the provisions creates uncertainty as to how far it applies which poses issues if a purpose of the rule framework is to:</p> <ul style="list-style-type: none"> <li>(a) enhance ASIC’s enforcement toolkit – a lack of certainty over what a provision means may jeopardise the prospect of a successful prosecution;</li> <li>(b) raise standards in the Australian market place – as operators and participants may not be clear on what is required to satisfy the requirements.</li> </ul> <p>For example, on the face of the definition both ASX (reference data/clearing/settlement/issuer administration) and ASIC (surveillance) provide critical systems for Chi-X and so each rule relating to critical systems and outsourcing will require Chi-X to complete the relevant obligations in respect of ASIC and the ASX.</p> <p>This is a perverse outcome.</p> <p>In addition, many critical services may be standardised services that provide enhanced security measures and protections through their standardised nature and ability to deliver an enhanced outcome due to economies of scale at the provider. The benefit to Chi-X of</p>

CP Number	Question	Chi-X Response
		<p>these services is using arrangements delivered by tier one providers. A negative is the inability to influence what is a global standard service. In these circumstances the rule will impose a series of tasks upon Chi-X for little or no benefit.</p> <p>The critical systems definition also applies on a one size fits all approach, which is not the case in relation to Regulation SCI (primary listing exchanges and ATS systems have different requirements), GDPR or MiFID requirements.</p> <p>Chi-X also has a concern that the proposed rules may enable the post event extension of regulatory obligations into areas that were not, on an ex ante basis, considered as caught by the obligations imposed by the rules. The “hindsight analysis” facilitated by the way the rules enhance ASIC’s enforcement toolkit, may be problematic.</p> <p>Chi-X has a large number of third party providers that will require analysis and due diligence under the proposed rule framework if the rules are made as proposed. This is not to say that the required standards are not currently being applied to those services, but the checklist applied may be an IOSCO checklist such that new due diligence would have to be undertaken to satisfy the requirements in the new rules.</p>
<b>B1Q2</b>	Do you agree that market participants and market operators should have rules that require them to have in place adequate arrangements for critical systems?	Chi-X is of the view that the existing regulatory framework already requires market operators to have adequate arrangements in place for critical systems and that the defects in this scheme have not been made out in a way that justifies a new rule regime with the risks and costs outlined herein.

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		<p>Chi-X is of the view that ASIC should clearly articulate why the existing framework is deficient before seeking to impose further obligations aimed at addressing an existing defect that is only implicitly covered in the CP.</p> <p>The existing principles based framework enables CXA to take a measured and proportionate approach to what is required. The rules risk imposing a “one size fits all” requirement on market operators.</p>
<b>B1Q3</b>	Do you agree with the types of arrangements that market participants and market operators should have to ensure the continued reliability of their critical systems?	<p>It is likely that it will be impossible to have certainty of compliance with the proposed framework and arrangements given the range of legitimate interpretations of what it may require.</p> <p>For example, Chi-X is required to have arrangements that “ensure [ASX/ASIC] has sufficient and scalable capacity for ongoing and planned operations and services”. This is not possible for Chi-X to achieve. Nor would it be possible in relation to other third party vendors upon whom Chi-X relies.</p> <p>Chi-X is also of the view that the proposed rule 8A.3.2 should be limited to material changes otherwise a market operator will be required to undertake the specified steps for any change, which, on its face, is excessive.</p>



CP Number	Question	Chi-X Response
<b>B1Q4</b>	Do you see any challenges for institutions in complying both with the proposed rules and other obligations they may be subject to including, for example, under Basel II or the Financial Stability Standards? In your response, please give detailed reasons for your answer	There is a potential for different outcomes and records to be queried. Chi-X is of the view that there is merit in aligning ASIC outcomes and due diligence records with those required by global frameworks that ASIC regulated firms may otherwise be required to meet.
<b>B1Q5</b>	How will these proposed rules affect your business? If you are a market operator or market participant, please provide an estimate of the time and costs to implement these arrangements. In providing this estimate, please compare this with your expenditure on your current critical systems arrangements	<p>The proposed rule framework predominantly takes a one size fits all approach and so may have a disproportionate impact on small to medium sized enterprises.</p> <p>Like many small to medium sized enterprises, Chi-X employees are engaged to undertake multiple functions. The proposed rule framework may require the addition of multiple FTEs whose sole responsibility is ensuring compliance with this new rule framework.</p>
<b>B2Q1</b>	Do you agree that market participants and market operators should have rules that require them to have in place adequate arrangements for change management of critical systems?	Chi-X is of the view that these obligations already exist under the applicable regulatory framework. The CP does not clearly explain why the current framework is inadequate.
<b>B2Q2</b>	Do you agree with our proposed rule? If you disagree, please give detailed reasons why	Chi-X is of the view that some interpretations of the rule will pose significant issues and resources demands on market operators.

CP Number	Question	Chi-X Response
<b>B2Q3</b>	How will this proposed rule affect your business? If you are a market participant or market operator, please provide an estimate of the time and costs to implement these arrangements. In providing this estimate, please compare this with your current expenditure on arrangements for change management of critical systems.	Please see the answer to B1Q5 above.
<b>B3Q1</b>	Do you agree with our proposed rule that requires market operators and market participants to have outsourcing arrangements? If not, please give detailed reasons why you disagree	<p>Chi-X is of the view that these outcomes are required by the existing regulatory framework.</p> <p>As outlined in the covering submission, there is a risk that the rules will require an excessive and disproportionate application of resources to ensure compliance for little or no net benefit. This is a real risk because markets will always seeks to err on the side of taking a conservative approach to ensure compliance with regulatory obligations and avoid regulatory sanctions.</p> <p>This negative impact may be addressed by further consultation which results in a rule framework with greater precision and/or one which permits a proportionate and risk based approach to compliance (see eg regulation 32 of the GDPR).</p>
<b>B3Q2</b>	Do you agree with the definition of 'outsourcing arrangement'? In your response, please give detailed reasons for your answer	Chi-X is of the view that the definition of outsourcing should be amended to ensure that it only applies to services that would be expected to be provided by the regulated entity in question.



CP Number	Question	Chi-X Response
		<p>The linking of “outsourcing arrangement” to critical systems means that the obligations may apply to any external service provider, not only those which provide a ‘regulated service’. This in effect extends the regulatory perimeter beyond that set by legislation and makes regulated entities responsible for requiring unregulated firms to meet regulatory standards.</p>
<p><b>B3Q3</b></p>	<p>Do you consider that the definition of ‘outsourcing arrangement’ covers the provision of services provided by all third-party service providers and not just those that may have been performed by the entity itself? If not, what if any risks do you see in relation to the provision of services by these entities?</p>	<p>Yes it does cover these entities and the CP does not undertake a cost benefit analysis of the extension of the regulatory perimeter to cover these entities.</p> <p>It is not appropriate for the rules to catch some third party vendor services (eg the market surveillance services undertaken by ASIC).</p> <p>There are also standardised services that should not be caught (see, for example, chapter 8 of the Senior arrangements, Systems and Controls Sourcebook in the FCA’s handbook).</p>
<p><b>B3Q4</b></p>	<p>Do you agree with the specific outsourcing arrangements proposed?</p>	<p>Chi-X is of the view that the outsourcing arrangements should be more clearly linked to activities that would be expected of the regulated entity, not all third party services.</p> <p>Chi-X is of the view that the outsourcing arrangements should be aligned with those required by existing global standards such as those required by IOSCO.</p>
<p><b>B3Q5</b></p>	<p>Do you consider that the risks associated with outsourcing to the cloud warrant a rule specific to that outsourcing arrangement? In</p>	<p>Ability to impact on cloud terms benefits – get better services from eh cloud than you do here</p>

CP Number	Question	Chi-X Response
	your response, please give reasons for your answer.	
B3Q6	How will these proposed rules affect your business? If you are a market participant or market operator, please provide an estimate of the time and costs to implement these arrangements. In providing this estimate, please compare this with your expenditure on your current outsourcing arrangements.	Please see the answer to B1Q5.
B4Q1	Do you agree with the proposed rules? If not, please give detailed reasons why you disagree	<p>Chi-X disagrees with the proposed rules.</p> <p>The rules prioritise the ability and ease of prosecution over all other regulatory outcomes by requiring market operators and participants “to <b>ensure</b> the confidentiality, integrity and security of data obtained, held or used by a market operator or market participant in connection with their operations or services”.</p> <p>It is impossible to ensure the outcome required by the Rule, even if limitless resources were dedicated to doing so.</p> <p>The strict liability for any breach of confidentiality, integrity or security is inappropriate.</p>

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		Regulations such as article 32 of the General Data Protection Regulation expressly recognise this in requiring firms to “implement appropriate technical and organisational measures to ensure a level of security appropriate to the risk [of the likelihood and severity of a breach]”.
<b>B4Q2</b>	Should the proposed requirement for market operators to notify ASIC of any unauthorised access to or use of their critical systems and market-sensitive, confidential or personal data be extended to market participants? Please provide detailed reasons for your answer.	Chi-X does not wish to express a view at this stage.
<b>B4Q3</b>	How will these proposed rules affect your business? If you are a market participant or market operator, please provide an estimate of the time and costs to implement these arrangements. In providing this estimate, please compare this with your expenditure on your data protection arrangements.	<p>If the rules proceed as proposed then Chi-X will be required to make an assessment of how much risk to assume in relation to what is a strict liability offence and this decision will directly impact on the amount of resources required to meet the rule requirements.</p> <p>If Chi-X takes a zero risk tolerance position, then the resources required to comply with the rule may be extensive, and up to 20% of the current FTE count.</p>
<b>B5Q1</b>	Do you agree with the definition of ‘incident’ and ‘major event’? In your response, please give detailed reasons for your answer.	<p>The breadth of the definition of ‘incident’ may pose significant issues.</p> <p>The breadth arises from:</p> <p>(a) the reference to ‘critical systems’ – see above;</p>

CP Number	Question	Chi-X Response
		<p>(b) the use of the term “unexpected interruption to the usual operation” is so high level and generalised that it will capture a very broad range of events;</p> <p>(c) the combination of (a) and (b) means that an Incident Management Plan may be required to capture substantially more incidents than are justified on any reasonable cost benefit analysis.</p>
<b>B5Q2</b>	Do you agree with our proposed rule that requires market operators and participants to have plans for dealing with an incident or major event? If not, please give detailed reasons why you disagree.	<p>Chi X is of the view that these requirements are adequately covered by the existing regulatory framework.</p> <p>Chi-X is of the view that the potential breadth of and lack of certainty in the definition of ‘incident’ may be problematic if the rules proceed as proposed.</p>
<b>B5Q3</b>	Do you agree with the frequency of reviewing and testing incident management and business continuity plans?	<p>Chi-X supports the text in the proposed rule 8A.4.1(3) that enables market operators to take an approach that is appropriate to the nature, scale and complexity of a operator’s critical systems. However, linking a review to any material change in a critical system, operation, service or structure, will require documentation of multiple reviews having been conducted during a year. Chi-X queries the extent to which these multiple reviews are justified on a cost benefit analysis.</p> <p>Therefore the internal bureaucracy required and created by this and associated rules is like to be extensive.</p>

CP Number	Question	Chi-X Response
<b>B5Q4</b>	Do you agree with the specific arrangements required in an incident management plan or business continuity plan?	Given the inability to predict future events, it would not be appropriate for market operators to be bound to follow the arrangements outlined in any plan at the expense of a more suitable course of action at the time an event occurs.
<b>B5Q5</b>	How will these proposed rules affect your business? If you are a market participant or market operator, please provide an estimate of the time and costs to implement these arrangements. In providing this estimate, please compare this with your expenditure on incident management and business continuity arrangements.	The rules may impose a significant internal bureaucracy and resource requirement on Chi-X.
<b>B6Q1</b>	Do you agree with our proposal to introduce this rule to ensure adequate governance arrangements and resourcing? If you do not agree, please provide detailed reasons why you disagree.	<p>Given the breadth of the rules and the strict liability nature of the offences, as outlined above, Chi-X is of the view that it is problematic to assess what governance arrangements may be suitable to comply with the obligations in the proposed rule framework.</p> <p>There may also be a query over the extent to which it is appropriate for the board to have oversight of testing and documentation of technical processes. The board may be entitled to rely upon the expertise and day to day oversight undertaken by the executive in relation to certain technology matters in which the board may have no expertise.</p>

CP Number	Question	Chi-X Response
<b>B6Q2</b>	How will these proposed rules affect your business? If you are a market participant or market operator, please provide an estimate of the time and costs to implement these arrangements. In providing this estimate, please compare this with your expenditure on governance arrangements.	Chi-X will be required to undertake a scoping exercise of the final rules and determine the extent to which the current governance and resources are adequate to meet the new requirements. This scoping may be impacted by the certainty and breadth issues discussed elsewhere.
<b>B7Q1</b>	Do you agree with our proposal to introduce this rule to ensure fair access to the market? If you do not agree, please provide detailed reasons why you disagree.	Chi-X is of the view that this requirement is adequately covered by the existing regulatory framework and the defects in this regime have not been clearly established.
<b>B7Q2</b>	How will this proposed rule affect your business? If you are a market operator, please provide an estimate of the time and costs to implement this fair access rule.	The current rule is unlikely to impose a significant additional burden if it is applied similarly to the existing regulatory framework with which Chi-X complies. The principles based language in the proposed rule may, however, be subject to more prescriptive guidance in future which could impose a more significant burden upon Chi-X.
<b>B8Q1</b>	Do you agree with our proposal to introduce trading controls? If you do not agree, please provide detailed reasons why you disagree.	Chi-X is of the view that the existing regulatory framework adequately deals with these matters.
<b>B8Q2</b>	How will these proposed rules affect your business? If you are a market operator, please provide an estimate of the time and costs to implement these trading controls.	Depending on the final text of the rule, Chi-X is likely to have the required controls in place already and so the impact may be minimal.

