



**ASIC**

Australian Securities &  
Investments Commission

## REPORT 644

# Assessment of ASX's arrangements for exchange traded AQUA products

December 2019

### About this report

This report presents the findings of our assessment of ASX Limited (ASX)'s compliance with its Australian market licence obligations. It focuses on ASX's arrangements related to admission to quotation and supervision of exchange traded products (ETPs) under the AQUA rules.

This report highlights a number of good practices we have observed, and also makes recommendations designed to improve ASX's arrangements in some areas. A number of the findings and recommendations will be relevant to other ETP market operators regulated by ASIC.

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- 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.

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Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.

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# Executive summary

## Background

- 1 The rapid growth of exchange traded product (ETP) markets has attracted considerable regulatory interest both in Australia and overseas. In [Report 583 Review of exchange traded products](#) (REP 583), we observed that in Australia, ETPs are increasingly popular with retail investors and self-managed superannuation funds (SMSFs) because of their accessibility, perceived low cost, transparency, intraday liquidity, diversification benefits and ability to provide exposure to new asset classes without owning those assets directly.
- 2 Over 2018–19, the market for ETPs in Australia continued to show strong growth in terms of funds under management, number of products admitted to trading and transacted value in these products.  
  
Note: See the 'Key terms' section below for detailed definitions of ETPs and exchange traded funds (ETFs). For those interested in understanding more about ETPs and ETFs, and the market for these products in Australia, we suggest REP 583 as a useful resource.
- 3 ASX Limited (ASX) plays an important role in facilitating the growth of the Australian ETP market by admitting and quoting ETPs on the ASX quoted assets (AQUA) market. ASX also has a supervisory role in ensuring that issuers comply with the market's AQUA rules on an ongoing basis.
- 4 In December 2017, ASX implemented a new AQUA and warrants approval process and admission procedures: see [Media Release \(17-453MR\) Exchange traded products: Guidelines for market licensees](#) (21 December 2017). This change involved ASX independently assessing the suitability of new products for admission to trading status. As a result, we stepped out of the day-to-day AQUA product admission process and indicated our intention to continue to engage with ASX on broader policy issues.
- 5 Also in December 2017, we released new guidance and recommendations in [Information Sheet 230 Exchange traded products: Admission guidelines](#) (INFO 230) to help ETP market operators understand our expectations on product suitability and admission requirements. Report 583, released in August 2018, contained further recommendations for ETP market operators based on our analysis of potential risks in this market segment.
- 6 We wrote to ASX to emphasise the importance of continuing to enhance not only its role in admissions but also its current supervision of the AQUA market. This included reference to more thorough monitoring of ETPs and ETP issuer compliance with relevant operating rules and admission conditions. At this time, we also gave ASX notice to expect an ASIC assessment in 12–18 months to review how well it had implemented the

changes, the nature of any issues it had identified and its approach to managing them.

- 7 We undertook our assessment of ASX under s794C of the *Corporations Act 2001* (Corporations Act) during 2019. The purpose of this assessment was to review how well ASX was complying with its general obligations as a market licensee in respect of the AQUA ETP market. This included an assessment of ASX's implementation of the changes to its AQUA and warrants approval process and admission procedures in December 2017, as well as a broader review of ASX's efforts to satisfy the regulatory expectations for ETP market operators set out in INFO 230 and REP 583.
- 8 This report summarises the observations, findings and recommendations from our assessment, organised around three key focus areas: AQUA market strategy, risk and governance; arrangements for operating the AQUA market (including monitoring and enforcement of the AQUA rules); and human resourcing of the AQUA market.

Note: On 30 July 2019, we implemented a pause on the admission of exchange traded managed funds that do not disclose their portfolio holdings daily and have internal market makers: see [Media Release \(19-195MR\)](#) *ASIC implements pause on admission of managed funds with internal market makers*. Our review of the regulatory settings for managed funds that use internal market makers is separate from the assessment of ASX's compliance with market licence obligations for the AQUA market summarised in this report.

## Key findings and recommendations

- 9 The AQUA ETP market is a comparatively new area of operation for ASX. Today, more than 10 years since the introduction of the AQUA market in 2008, this market segment is reasonably well established, but still not fully mature. It is important that the findings and recommendations from our assessment of ASX's AQUA market for ETPs are read in the context of the broader growth and development of this market segment.
- 10 As new market segments grow and become increasingly sophisticated, we expect market operators to review, revise and adapt their arrangements for operating the market accordingly—and to be aware of incremental changes to the ETP market over time. The establishment phase for the AQUA market was characterised by more direct ASIC oversight and involvement in ASX processes and procedures, which has reduced over time as ASX developed the market, including the AQUA rule framework. This was also based on the expectation that the ASX gatekeeper role would reach a mature state over that time. In making the recommendations below, we seek to challenge ASX to more proactively set the direction and standards for this market segment in the next phase of its development.

- 11 Overall, we are satisfied that ASX had adequate arrangements to meet its obligations as a licensed market under s792A of the Corporations Act during the assessment period (1 January 2018 to 5 February 2019). However, our assessment identified a range of areas where ASX's arrangements for the AQUA market could be improved to align more closely with regulatory guidance and our expectations of ETP market operators.

### **AQUA market strategy, risk and governance**

- 12 ASX is an established market operator with evolving corporate governance structures, policies and procedures. We assessed whether and how these existing governance structures had adapted to give appropriate focus to, and provide avenues for escalation of, AQUA-specific matters and issues.
- 13 Our overarching finding in this area is that, until very recently, the investment products area (which includes the AQUA market for ETPs) had a low profile, in the broader context of ASX's business and other compliance monitoring activities, with senior executives and the board. In our view, deficiencies in board reporting likely contributed to a narrow focus on market growth and lack of strategic direction from the highest levels of the organisation. This resulted in the size and maturity of the market outpacing the development and sophistication of ASX's processes and systems to operate and monitor it.
- 14 ASX has not addressed our recommendation from REP 583 to implement a clear strategy about the nature of products they quote on their market, guided by domestic and global market trends and relevant emerging risks. In our view, the continued absence of such a strategy, in combination with nascent risk management frameworks specific to this area, significantly compromises ASX's ability to discharge its gatekeeper responsibilities and assess whether the ETP market is developing in a manner consistent with its risk appetite over time. This has negatively impacted the effectiveness of AQUA market governance in practice, particularly with regard to executive decision-making and prioritisation of emerging risks and issues.
- 15 During the assessment period, we observed renewed focus on the AQUA market in other areas, including a more proactive approach to meeting regulatory obligations and expectations. Improvements were made to board reporting just following the assessment period. We have also been advised that work on developing more specific key risk indicators (KRIs) for investment products is in progress.
- 16 Our major recommendation in this area is that ASX should ensure the shift towards a more proactive approach to AQUA market compliance and continuous improvement is maintained. This should include the development of a clear strategy for ETPs and prompt completion of ASX's ongoing work to strengthen and internally promote its 'three lines of defence' risk management framework. Forging strong links between strategy, risk and the

AQUA ETP admissions framework will help ASX to keep abreast of all the incremental changes to this market segment as it matures.

- 17 Section B of this report contains our detailed findings and recommendations for ASX in this area.

### **Arrangements for operating the AQUA market**

- 18 We found that ASX's implementation of its new AQUA and warrants approval process and admission procedures from December 2017 was effective. The implementation of the new admission process and procedures was supported by a range of further improvements to related policies, templates and systems initiated by ASX during the assessment period.
- 19 However, a more detailed review of the new AQUA ETP admission procedures in practice revealed areas for further improvement. We observed potential or perceived conflicts in the expectations and frameworks that were put in place around members of ASX's Investment Products onboarding team. Specifically, we are concerned that ASX's Investment Products onboarding team has an inappropriate level of influence over the admission process, in the context of this team's current role and individual key performance indicators (KPIs). ASX's AQUA admission process would also benefit from greater discipline when relying on precedent and improvements to record-keeping.
- 20 In a letter sent to ASX in December 2017, we recommended that it should continue to enhance its supervision and monitoring of the AQUA market. As a result, we expected to see a degree of improvement to these AQUA market arrangements during the assessment period. We found some areas where ASX met or exceeded our expectations and successfully implemented changes to supervision and monitoring of the AQUA market. For example, ASX's ability to supervise and monitor the AQUA market has improved significantly following the creation of a dedicated Investment Products Compliance Manager role. Technology upgrades were also completed after the assessment period to more adequately support the work of the Investment Products Compliance function.
- 21 However, we also identified several areas where ASX's arrangements for monitoring the AQUA market could still be improved. Notably, ASX has not yet fully implemented our recommendations from REP 583 for ETP liquidity monitoring. Work has commenced on new systems and tools, and significant progress was made both during and after the assessment period. The remaining system development should be completed as soon as practicable in order to meet regulatory expectations.
- 22 Section C of this report contains our detailed findings and recommendations for ASX in this area.

## Resourcing the AQUA market

- 23      Our assessment focused on the adequacy of human resourcing dedicated to the AQUA market, as distinct from financial or technological resources.
- 24      We observed signs of workload strain on 'Line 1' AQUA market personnel throughout the assessment period. ASX took steps to address this through changes to structure and an increase to headcount during and after the assessment period. However, we are concerned that the strain we observed was protracted and affected ASX's ability to meet regulatory expectations at the time.
- 25      In relation to a request we made of ASX to benchmark its rule frameworks for ETPs against those of other major jurisdictions, ASX was unable to complete what we requested within a reasonable timeframe, taking almost two years to deliver a summary of the work completed. The lean nature of ASX's workforce in this area likely contributed to some of the other delays in implementing improvements—for example, those related to supervision and monitoring of the AQUA market.
- 26      In light of the recommendations in this report, ASX should consider in detail how to more rigorously monitor the adequacy of resourcing for the AQUA market on an ongoing basis. ASX should ensure the growth of the market does not outpace ASX's ability to adequately operate it in the future. We also encourage ASX to more proactively consider how to manage known risks associated with current resourcing structures, including key person risk.
- 27      Section D of this report contains our detailed findings and recommendations for ASX in this area.

## Next steps

- 28      As noted in REP 583, we are continuing to engage with the ETP industry to monitor the development of the market and the experience retail investors are having when engaging with or investing in this market.
- 29      We have been conducting a review of the regulatory settings for exchange traded managed funds that use internal market makers, which has occurred alongside our review of the ASX AQUA market. We are issuing a separate report on our findings of the regulatory settings and will cover our expectations for relevant products quoted across different market operators.
- 30      We will continue to liaise with ASX to monitor its implementation of our recommendations, as well as with both ETP market operators on policy and other issues concerning the ETP market in Australia.



## A Background

### Key points

Since its launch in 2008, ASX's AQUA market has grown substantially and become more diverse and sophisticated. Whereas the first AQUA products were generally simple, passive investment products, there is now a broader range of more complex products admitted to quotation on ASX's market.

Under s794C of the Corporations Act, we may conduct an assessment of how well a market licensee is complying with any or all of its licence obligations.

Following ASX's introduction of a new AQUA and warrants approval process and admission procedures in December 2017, we undertook a 'deep dive' assessment during 2019 to determine how well ASX had implemented the new processes and procedures, as well as a broader review of the adequacy of ASX's arrangements for, and human resourcing allocated to, operating the AQUA market.

## ASX's AQUA market

### History and context

- 31 ASX's AQUA market for ETPs launched with the first AQUA ETFs admitted in September 2008. This was followed by actively managed exchange traded funds in July 2012. Prior to the development of market operating rules for the AQUA market (AQUA rules), open-ended ETFs had been admitted under the ASX Listing Rules since 2001, with rule waivers granted where necessary to facilitate their admission and operation.
- 32 Over time, the AQUA market has evolved from simpler, index-tracking passive investment products with full physical replication to a range of more complex products. This includes synthetic funds with substantial positions in over-the-counter (OTC) derivatives, hedge funds with complex investment strategies, and actively managed funds that do not track an index.
- 33 In the broader context of ASX Group's business activities, the fees associated with initial admission, ongoing quotation, and trading of ETPs do not represent a significant proportion of ASX's revenue.

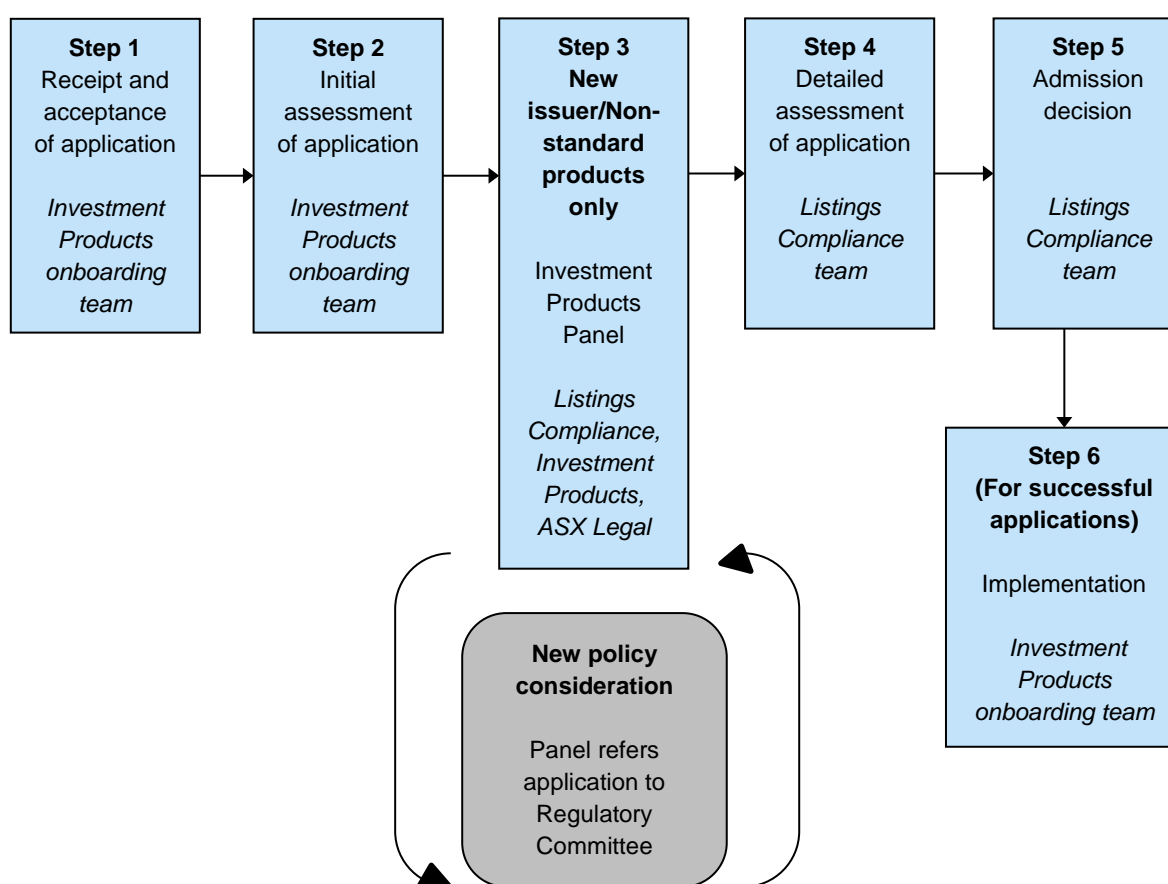
Note: ETPs are just one of a number of fund segments managed by ASX's Investment Products business area. Investment Products is in turn part of ASX's Listings and Issuer Services business—revenue for this area includes fees associated with initial admission and ongoing quotation of ETPs. Fees generated as a result of the trading of ETPs are included in revenue of the Trading Services business. See ASX's annual reports for further information about these business areas.

- 34 The trading of ETPs takes place on the same infrastructure as ASX's traditional listed equities market (ASX Trade). The AQUA market is not separate or distinct market infrastructure from a technological standpoint.

### The AQUA ETP admission process

- 35 The formal admission process for AQUA ETPs commences when ASX receives an application for admission in accordance with the AQUA rules. Figure 1 highlights the six steps in the admission process for ASX ETPs in accordance with the procedures for warrants and AQUA products.

**Figure 1: ETP admission process**



Note: See Appendix 2 for a more detailed explanation of the process shown in this figure.

## Our assessment of ASX Limited

- 36 On 7 December 2017, we agreed to ASX implementing a new AQUA and warrants approval process and admission procedures. These were designed to align the AQUA market to the ASIC–ASX approach to the administration of listing standards in the securities market.

- 37 Previously, we were also involved after Step 3 (but before Step 4) of ASX's admission process for 'non-standard' ETPs. Like the Investment Products Panel, we also considered case-by-case 'novel' AQUA product referrals from ASX. Now, as a result of the change to the admission procedures in December 2017, we no longer receive these referrals, giving ASX more flexibility to independently assess new product applications and perform its gatekeeper role. We continue to actively engage with ASX on broader policy issues related to ETPs.
- 38 At the time we consented to the new AQUA and warrants approval process and procedures, we wrote to ASX to note the following:
- (a) It is important that ASX continues to enhance its supervision of the AQUA market. This will include thorough monitoring of ETPs and compliance with the relevant operating rules and admission conditions. This should involve active monitoring and not just attestations from issuers. This may require ASX to assess whether it has sufficient resources (e.g. strategic, legal and compliance) allocated to the AQUA market.
  - (b) As part of our commitment to stepping out of the day-to-day admission process for AQUA products, we will conduct a deep dive assessment on the AQUA market in 12–18 months to review how ASX has implemented the changes and the nature of issues identified by ASX and the approach to managing them.
- 39 On 21 December 2017, we released INFO 230 to set clear and consistent standards for all licensed market operators seeking to admit ETPs to their market. REP 583, released in August 2018, contained further recommendations about potential risks associated with ETPs that require oversight by market operators.
- 40 Our aim in giving ASX advance notice of our assessment and releasing additional guidance about our expectations for ETP market operators in the interim was to encourage ASX to make immediate improvements to ensure its admission and monitoring standards for ETPs continued to support fair, orderly and transparent markets.

### **Purpose, scope and methodology**

- 41 The purpose of our assessment was to review how well ASX implemented the changes to AQUA admission processes and procedures, and form a view as to the adequacy of ASX's arrangements for, and resourcing allocated to, operating the AQUA market.
- 42 We did this by conducting an assessment of ASX's compliance with the general market licence obligations contained in s792A of the Corporations Act

for the period January 2018 to February 2019. We also considered ASX's adoption and implementation of more specific regulatory guidance and expectations for ETP market operators set out in INFO 230 and REP 583.

- 43 The scope of our assessment focused on AQUA market governance, strategy and oversight arrangements, and arrangements for monitoring and enforcing compliance with the AQUA rules. We also reviewed whether and how ASX determined that it had allocated sufficient human resources to operate this market segment properly during the assessment period.
- 44 In assessing the adequacy of ASX's arrangements for operating the market (i.e. its policies and procedures and adherence to them), we did not consider the appropriateness of substantive decisions made by ASX (e.g. to admit or reject applications for admission of AQUA products, or to take enforcement actions against AQUA product issuers).
- 45 See Appendix 3 for more detailed information about the scope and methodology of our assessment.

## Work undertaken by ASX during 2018 and 2019

- 46 Consistent with our expectations, and knowing that we planned to conduct a future assessment on the AQUA market, ASX completed substantial work during the 2018 and 2019 calendar years to improve its arrangements for operating the AQUA market for ETPs.

### Gap analysis

- 47 In May 2018, ASX's Listings Compliance and Investment Products onboarding teams started work to analyse and compare ASX's current practices against the regulatory expectations set out in INFO 230. Following the release of REP 583 in August 2018, ASX extended its analysis to incorporate additional considerations and recommendations from that report. This gap analysis work was substantially completed by September 2018, although further refinements continued to be made into early 2019.
- 48 In our view, the gap analysis was a useful exercise that enabled ASX to assess relevant processes or controls against the expectations outlined in INFO 230 and REP 583, identify areas for improvement and summarise potential actions. This analysis helped ASX to identify key areas requiring improvement and served as the basis for a program of work that it commenced in September 2018—the 'Investment Products Work Plan'.

## Investment Products Work Plan

- 49 ASX had completed 41 tasks from the Investment Products Work Plan (as at February 2019) before our assessment began. However, at the time of writing, ASX advised that two additional tasks had been added to the work plan, and eight tasks in total were still outstanding. The final task listed on the workplan is not due to be completed until 2021.
- 50 The work plan covered a wide range of tasks, including:
- (a) engaging a new Investment Products Compliance Manager;
  - (b) validating various records maintained by the Investment Products and ASX Compliance teams;
  - (c) validating the split of work and level of resourcing for Investment Products and ASX Compliance;
  - (d) updating information on ASX's public website;
  - (e) updating various policies, procedures, forms and checklists;
  - (f) preparing new or amended AQUA rules, procedures and guidance; and
  - (g) updating or developing new and improved systems and other tools (mostly related to data capture and monitoring of the market).
- 51 ASX's Listings Compliance area had overall responsibility for managing the progress of the work plan, with the completion of specific tasks assigned to members of the Listings Compliance and Investment Products teams.
- 52 The work plan was a useful exercise with some immediate benefits for ASX and external stakeholders, as well as laying a foundation for further improvements in the next few years. In particular, the benefits to be gained from planned future AQUA rule changes, as well as ASX's new and improved internal systems and other tools, will require some time to be fully realised.
- 53 Sections B, C and D of this report will discuss specific aspects of the Investment Products Work Plan in more detail to highlight areas where ASX has met regulatory expectations as a result of this work, and also areas where we recommend that further work needs to be done.

## B AQUA market strategy, risk and governance

### Key points

Exchange market operators such as ASX play a gatekeeping role in deciding which products may be traded on a public market accessible to retail investors.

In executing this important role, we expect market operators to have a clear strategy about the nature of products they quote on their market, guided by domestic and global market trends and relevant emerging risks.

Until recently, the Investment Products area (which includes AQUA ETPs) has had a low profile at ASX relative to more established business lines. There are some elements of ASX's strategy for ETPs, risk management practices and governance of the AQUA market that we consider could be improved.

### Overview

- 54 In order to meet their statutory obligations to 'do all things necessary' to ensure that the market is 'fair, orderly and transparent' and have 'adequate arrangements for operating the market', financial market operators should have a clear product strategy and effective frameworks for managing risk and for governance of the market: s792A(1)(a) and s792A(1)(c) of the Corporations Act.
- 55 We have more specific expectations of markets with a listing or admission function. In the past we have focused regulatory attention on ASX's listing standards for equities: see [Report 480](#) *Assessment of ASX Limited's listing standards for equities* (REP 480). Appendix 1: Principles for listing rules was published in [Regulatory Guide 172](#) *Financial markets: Domestic and overseas operators* (RG 172). We consider that the 'Principles for good governance' contained in Appendix 1 of RG 172 are equally applicable to market operators that admit ETPs to trading status: see RG 172.481–RG 172.483.
- 56 More recently, in REP 583, we attached more specific expectations to market operators responsible for admitting ETPs as follows:
- Exchange market operators play a gatekeeping role in deciding which products may be traded on a public market accessible to retail investors. They set the admission requirements for ETPs and issuers, and assess the overall suitability of products proposed for quotation. Market operators are also responsible for the ongoing supervision of issuers, including compliance with liquidity commitments and ongoing disclosure requirements, and for the monitoring of the market more broadly—to ensure its fair, orderly and transparent operation. This provides market

operators with a unique role and responsibility to oversee and shape important elements of the ETP market.

We expect market operators, in executing this important role, to have a clear strategy about the nature of products they quote on their market. They should be guided by domestic and global market trends and relevant emerging risks. The risk management plans of market operators should also consider the impact of these trends and risks on the overall health of the Australian ETP market.

- 57 An effective strategy about the nature of products suitable to be quoted on the market should assist the market operator to set a principled direction for the growth and development of the market it operates.
- 58 In developing such a strategy, it is not the role of the market operator to 'pick winners' or map out in advance every possible permutation of ETP structure and investment strategy that it would deem acceptable for admission. Ultimately, each ETP admitted to trading must comply with the market's operating rules. However, market operating rules are not static, nor do they exist in a vacuum. While the operating rules can be used to answer the question, 'Is this product eligible to trade on the market?', the strategy should seek to address the broader questions of 'What is the purpose of this market? What types of products should we allow to be traded on the market?'
- 59 In practical terms, the purpose of a strategy about the nature of products suitable to be quoted on the market is twofold. First, where there is ambiguity or discretion on the part of the market operator to interpret the scope or application of operating rules, the strategy can help guide day-to-day decision-making. Second, in the longer term, the strategy will act as a guidepost. It should be used to help the market operator assess whether the sum of incremental decisions made under the operating rules has in fact resulted in market development consistent with its purpose and the operator's risk appetite. This may in turn prompt further development of admission rule frameworks, if necessary, to ensure that the market remains true to its fundamental purpose—that it serves the interests of investors and is fair, orderly and transparent.

## Observations and findings

- 60 ASX is an established market operator with evolving corporate governance structures, policies and procedures. However, the AQUA ETP market is, in relative terms, a new area of business for ASX. During our assessment we sought to understand whether and how these existing governance structures had adapted to give appropriate focus to, and provide avenues for escalation of, AQUA-specific matters and issues.

61 Overall, we were satisfied that ASX had adequate governance and oversight arrangements and structures in place for escalation of AQUA ETP matters and issues and for monitoring compliance with market licence obligations during the assessment period. However, these structures were not always effective in practice. We found that the comparatively low profile of this business area at senior executive and board level resulted in the failure to fully implement earlier ASIC recommendations. This compromises ASX's ability to act and make decisions consistent with its role as an effective gatekeeper. Based on our observations and the findings below, we have made several recommendations concerning areas that could be improved to ensure ASX is able to meet regulatory expectations.

### **Profile of the Investment Products area**

62 Until recently, the Investment Products area (which includes the AQUA market for ETPs) had a low profile in the broader context of ASX's business and other compliance monitoring activities. This area received little specific attention and guidance from ASX's board and senior management, compared to other more established business lines.

63 The ASX board is responsible for reviewing and overseeing systems of risk management and internal control and regulatory compliance, including compliance by ASX Group's market licensees with their statutory obligations as licence holders. The board is assisted in this task by the Audit and Risk Committee (ARC), which reviews regular reports from ASX's management team related to compliance with statutory, licence and other key obligations and matters.

64 During the assessment period, the ASX board received regular reports from both the Chief Compliance Officer (who leads the Listings Compliance team) and the Executive General Manager, Listings and Issuer Services (who leads the Investment Products team). The ARC also received regular reports from the Chief Compliance Officer.

65 In summary, we found that updates to the board on AQUA ETP issues tended to be narrowly focused on ETP market growth, with some information also provided on specific strategic initiatives and the state of competition for investment products. Compliance updates contained no dedicated section on investment products (including AQUA) information or issues. Although there was potential for information on AQUA ETPs to be included in other sections of these reports under general headings, this did not occur often in practice. Updates to the ARC also typically focused on information relevant to listed equities.

66 In our view, this information was insufficient to enable the board to get a clear picture of the state of ASX's compliance with its market licence obligations and regulatory expectations in this area. As one example, in



relation to REP 583, the board and the ARC were given general information about the report and ASX's response. However, none of the various updates included a holistic and detailed summary of what our recommendations for market operators were, or specific information about how ASX planned to address them and in what timeframe. In our view, such information should have been provided to the board and the ARC for transparency and to better facilitate executive accountability.

- 67 As outlined in more detail in Section C, at the start of the assessment period the size and maturity of the market had outpaced the development and sophistication of ASX's processes and systems to operate and monitor it. In our view, the low profile of this market segment and narrow focus of information flow from senior management to the board is likely to have contributed to this and the findings below regarding shortcomings in AQUA market strategy and risk management.

### **AQUA ETP market strategy and governance**

- 68 ASX has not adopted our recommendation from REP 583 that ETP market operators should implement a clear strategy about the nature of products quoted on the market, guided by domestic and global market trends and relevant emerging risks.
- 69 ASX sets annual group level goals for its businesses through its 'Vision, Strategy, Execution' (VSE) framework. VSE goals are assigned to members of the ASX executive team and, as relevant, cascaded down through the organisation to the performance agreements of individual ASX staff members, who assist with their delivery. These goals are split into two major categories: 'Licence to Operate' and 'Growth Initiatives'.

Note: In the context of ASX's VSE framework, 'Licence to Operate' refers to a range of activities that maintain ASX's brand, integrity and core operations. This is a broader concept than the terms of ASX's market licence.

- 70 During the assessment period, ASX set a number of annual VSE goals with direct relevance to the development and growth of the AQUA ETP market. However, we observed little evidence of a unified, overarching strategy about the nature of products suitable for admission, or that set a direction for this market in the medium to longer term, balancing both commercial and regulatory/compliance outcomes. While the VSE appeared effective in ensuring that specific AQUA-related goals or initiatives were carried out during the assessment period, those goals did not appear to align with any broader purpose or vision for this particular market segment.
- 71 In relation to the content of the VSE goals we reviewed, we also identified one instance where a growth target was cascaded to individual Listings Compliance staff performance goals. In our view, this goal was not consistent with the fundamental duty of these staff members to

independently assess the suitability of ETPs for admission to trading status. Although it does not appear this goal negatively impacted admission outcomes in practice, we remain of the view that poorly designed incentives for staff with a regulatory or compliance function have significant potential to undermine the integrity of the admission process.

- 72 We consider that, in practice, ASX has not substantively implemented our recommendation from REP 583, and we are concerned that this shows inadequate commitment to assessing whether the market is developing in line with its risk appetite. In our view, this has negatively impacted the effectiveness of AQUA market governance, particularly with regard to executive decision-making and prioritisation and management of emerging risks and issues. We reviewed instances of poor communication between ASX teams which did not demonstrate a principled and well-documented process for making key decisions. To the extent that governance frameworks did not support decision-making in a manner consistent with the effective discharge of its gatekeeper responsibilities, this does not meet regulatory expectations in this area.

### **The relevance of risk to strategy and decision-making**

- 73 Risk management is an area that ASX has focused a lot of attention on in recent years. [Report 592](#) *Review of ASX Group's technology governance and operational risk management standards* (REP 592) contained a number of recommendations related to strengthening ASX's operational risk management, and a summary of the steps ASX Group had decided to focus on to further improve its enterprise-wide risk management practices. A significant amount of this work, including development of business unit level KRIs across the organisation, is due to be completed by the end of the 2019 calendar year.
- 74 ASX staff we interviewed during our assessment were generally familiar with ASX's recently revised Risk Appetite Statement (RAS) and its importance, but less confident when asked about practical implications of the RAS in their day-to-day activities, and how the identification of emerging risks might influence their work. Although staff were aware that business unit level KRIs were being developed, we observed that, in the absence of such frameworks, there was low awareness and understanding of how to identify or manage key risks in practice.
- 75 In summary, with reference to ASX's 'three lines of defence' framework, it was not clear to us that the Line 1 staff in this area properly owned and were accountable for managing risk in their areas.

Note: ASX Group follows the 'three lines of defence' model for risk management. Line 1 owns and is accountable for managing risk. Line 2 is the Risk Management and Enterprise Compliance function, and is accountable for providing advice, challenge, frameworks and independent reporting. Internal Audit is Line 3 and is responsible for assurance.

- 76 We also found that while work to identify relevant trends and emerging domestic and global risks did occur during the assessment period, this work was not supported by particularly robust internal processes and frameworks.
- 77 ASX implemented some improvements related to identification and reporting of investment product risks and trends subsequent to the assessment period. As part of the Investment Products Work Plan, a new meeting (intended to be held annually) was convened in late February 2019 to consider strategy, risks and emerging trends in the investment products area. The establishment of this forum could be a useful starting point for the development of a clearer ASX strategy covering AQUA ETPs, as well as more fulsome consideration of how the strategy and day-to-day decision-making could be guided or informed by relevant emerging risks.

### **ASX's internal compliance review processes and continuous improvement**

- 78 Prior to our assessment, ASX identified that work was required to meet regulatory expectations in INFO 230 and REP 583 and set in motion the Investment Products Work Plan to address these gaps.
- 79 Some of the tasks ASX identified in its work plan as requiring attention had no direct relationship to our recommendations in INFO 230 or REP 583. In some cases, we were encouraged to see ASX initiate improvements—after a detailed review of its own practices—that went beyond the expectations set out in INFO 230 and REP 583. In other areas, it seemed that ASX had not prioritised ongoing review of some aspects of its arrangements for operating the AQUA market before the assessment period. This meant that a more significant uplift was required during 2018 than if ASX had undertaken regular internal reviews and updates of its policies, procedures and processes.
- 80 As a result of the Investment Products Work Plan, ASX has improved its arrangements by clarifying who—between Listings Compliance and Investment Products onboarding staff—is responsible for the execution of a range of day-to-day tasks related to AQUA ETPs. However, there is room for further improvement. ASX should also clarify which team or individuals are responsible for driving longer-term improvement to policies, processes and procedures. In order to meet regulatory expectations, time and attention must be given to review and continuous improvement of arrangements for operating the market irrespective of whether this happens to be a VSE focus in a given year.

- 81 The adequacy of internal review processes is also tied to the effectiveness of broader governance, risk and other oversight mechanisms. During the assessment period, we observed that ASX's 'three lines of defence' mechanism was not as effective as it should have been in bolstering ASX's AQUA market regulatory compliance.
- 82 ASX's gap analysis and Investment Products Work Plan were both driven by Line 1 staff. In parallel, an Enterprise Compliance (Line 2) review into the AQUA market was also conducted during the assessment period. However, the Enterprise Compliance review lacked impact at the time, largely due to the significant overlap in both timing and substance with the concurrent Line 1 review. A Line 2 review would likely have had greater relevance and impact if it had been completed before the Line 1 review (to help scope and identify areas for improvement) or afterwards (to validate the effectiveness of the implementation of any changes).

### **Other improvements made during and after the assessment period**

- 83 During and after the assessment period, we observed that ASX's approach to the AQUA ETP market was starting to shift. There has been renewed focus on this market, and ASX has taken steps to be more proactive in meeting regulatory obligations and expectations. This is a trend we encourage ASX to continue and ensure remains supported by adequate resourcing: see Section D.
- 84 In particular, ASX's extension of the Investment Products Work Plan subsequent to our assessment is a positive step towards consolidating a practice of ongoing review and improvement work for the AQUA ETP area. After the assessment period, we were also advised that changes had been made to relevant board and ARC reports to include more information on investment products, including AQUA ETPs. With these changes made to ASX board and ARC reporting, ASX currently meets regulatory expectations in this area.
- 85 We also note recent system upgrades that ASX has completed as part of its Investment Products Work Plan (reviewed during our site visit to ASX in September 2019). We expect that these upgrades will also significantly enhance ASX's ability to aggregate, monitor and compile information on AQUA compliance matters.

## Recommendations

86 Table 1 sets out a summary of our findings and recommendations in relation to AQUA market governance, risk and strategy.

**Table 1: AQUA market governance, risk and strategy—findings and recommendations**

Findings	Recommendations
<p><b>AQUA market development, review and continuous improvement needs to be prioritised on an ongoing basis</b></p> <p>It is not consistent with regulatory expectations for market operators to take a primarily reactive approach and consider new or updated ASIC guidance or policy to be the main driver for internal review.</p> <p>The relatively low profile of the Investment Products business area, characterised by insufficient information flow and lack of specific oversight and guidance from ASX senior executives and the board, resulted in the growth of the market outpacing the development of ASX's processes and systems to operate and monitor it.</p> <p>During and after the assessment period, ASX took steps to adopt a more proactive stance on internal compliance review processes and continuous improvement.</p> <p>We consider ASX's extension of the Investment Products Work Plan subsequent to our assessment is a positive step towards consolidating a practice of ongoing review and improvement work for the AQUA ETP area.</p>	<p>Review and continuous improvement are essential to ensure that good practice from the wider market or other parts of the market operator's business are adopted in a timely manner.</p> <p>We encourage all market operators to proactively conduct regular reviews of their compliance with market licence obligations and make improvements where necessary.</p> <p>ASX should take further steps to consolidate the focus and momentum gained from prioritisation of AQUA-related work during the assessment period. In particular:</p> <ul style="list-style-type: none"> <li>ASX should clarify which team and/or individuals are responsible for identifying and implementing improvements to AQUA market policies, procedures and processes on an ongoing basis, and set relevant KPIs to facilitate this; and</li> <li>once ASX has established a clearer strategy for the market and finished strengthening risk frameworks (see recommendations below), it should complete a more holistic review of its arrangements for the AQUA market to verify alignment (e.g. strategy and governance, risk, people, processes and technology, or similar).</li> </ul>
<p><b>ASX lacks a medium- to longer-term strategy for the development of the AQUA ETP market</b></p> <p>ASX has not substantively adopted our recommendation from REP 583 to implement a clear strategy about the nature of products they quote on their market, guided by domestic and global market trends and relevant emerging risks.</p> <p>The continued absence of such a strategy significantly compromises ASX's ability to discharge its gatekeeper responsibilities and assess whether the ETP market is developing in a manner consistent with its risk appetite over time.</p> <p>Such a strategy could potentially be broader than AQUA ETPs, but should aim, at a minimum, to set a principled basis for distinction between investment products suitable to be admitted to trading as compared to non-traded products.</p>	<p>ASX's management team should develop and approve a strategy about the nature of products suitable to be quoted on the market in order to set a direction for the AQUA ETP market in the medium to longer term.</p> <p>Related to this, there should be explicit consideration of how annual AQUA-related VSE goals contribute to this overarching strategy, and also how they relate to, or support, one another.</p> <p>ASX should also take greater care to ensure that VSE goals are cascaded appropriately to relevant staff each year.</p>

Findings	Recommendations
<p><b>ASX should continue its work to strengthen and enhance its risk frameworks</b></p> <p>In general, criteria for the admission of ETPs are less detailed and onerous than requirements for listing. In our view, this does not make ETPs inherently less complex or less risky than listed equities.</p> <p>During the assessment, we identified some areas of weakness in ASX's 'three lines of defence'. Line 1 staff lacked a detailed understanding of how ASX's risk frameworks apply to their day-to-day activities. In addition, an Enterprise Compliance (Line 2) review undertaken during the assessment period lacked impact at the time, largely due to the very significant overlap in both timing and substance with a concurrent Line 1 review.</p> <p>ASX's development of a strategy for the AQUA ETP market should be complemented by enhancements to its frameworks and processes for identifying and assessing market trends and emerging risks.</p>	<p>ASX should address identified areas of weakness and continue its work to strengthen its 'three lines of defence' risk management framework to ensure that all staff develop a more fulsome understanding of the framework and how it applies to their work. There should be clearer accountability for the identification and management of risks associated with the AQUA market and consequences when this does not occur in practice.</p> <p>In connection with strengthening its 'three lines of defence' risk management framework, ASX could improve the structure of its regular internal compliance review program to facilitate its three lines of defence supporting one another more effectively (across its business and not only in relation to the AQUA ETP market).</p> <p>ASX should also consider whether a more rigorous framework and process for analysis and consideration of emerging risks would have benefits for investment products (including AQUA ETPs) and beyond.</p>
<p><b>ASX should continue to enhance its ability to monitor compliance with licence obligations and make decisions based on data and evidence</b></p> <p>During the assessment period, the board did not receive sufficient information to assess the state of ASX's compliance with market licence obligations in this area.</p> <p>Subsequent to the assessment period, ASX implemented changes to board and ARC reporting to include more detailed information on investment products (including AQUA ETP) issues.</p> <p>ASX also very recently implemented system upgrades that will significantly enhance its ability to aggregate and compile information on AQUA compliance matters.</p>	<p>ETPs have unique features that are unlike other listed products. Market operators such as ASX should proactively foster and develop increased awareness and understanding of these products and associated risks at all levels of the organisation.</p> <p>As ASX builds a more holistic picture of AQUA compliance and other matters, staff should consider how to incorporate this information into board and other regular management reporting. Specifically:</p> <ul style="list-style-type: none"> <li>ASX should consider how, over time, improvements can be made to all levels of reporting on AQUA ETP trends, monitoring, risks, compliance and other issues; and</li> <li>we encourage ASX to complete the remaining items on the Investment Products Work Plan aimed at facilitating improved data capture and reporting of AQUA matters.</li> </ul> <p>As a starting point, we expect that the board will be briefed in detail on the recommendations in this report and ensure that ASX executives are held accountable for their implementation.</p>

## C Arrangements for operating the AQUA market

### Key points

Each Australian market licensee is responsible for the proper operation of its own market venue. This includes setting the operating rules that govern the core operational functioning of the market venue and the admission standards for issuers, listees and participants.

In our assessment we focused on ASX's arrangements for approval of AQUA product issuers, admission of AQUA ETPs, and monitoring of AQUA products and product issuers to detect potential or actual non-compliance with the AQUA rules. We also considered how ASX handles and manages conflicts of interest that may arise in the course of operating this segment of its market.

Although we found that ASX's arrangements were adequate in terms of supporting robust admission and compliance outcomes, we identified some structural weaknesses and other areas for improvement that should be remedied in the medium to longer term in order to meet regulatory expectations.

### Overview

- 87 Under s792A(1)(c) of the Corporations Act, a market licensee must have adequate arrangements for operating the market. In assessing how well a licensee is complying with this obligation we will consider a wide range of arrangements. This includes how the market licensee handles conflicts of interest and how it monitors and enforces compliance with its operating rules and its complaints handling processes and procedures, among others: see RG 172.118.
- 88 Operators of markets with a listing or admission function should design their arrangements to achieve high-quality and robust listing and admission outcomes. This includes processes requiring that admission applications are carefully and rigorously reviewed and verified to ensure that applicants meet relevant admission requirements. In addition, where there are specific ongoing requirements for issuers and listees under the operating rules, this will also include arrangements to monitor compliance with those obligations: see RG 172.131.
- 89 Consistent with the scope of the present assessment, this section of the report contains our observations and findings on ASX's arrangements for the approval of AQUA product issuers, admission of AQUA ETPs, and monitoring of AQUA products and product issuers to detect potential or actual non-compliance with the AQUA rules. We have also considered how ASX handles and manages conflicts of interest that may arise in the course of operating this segment of its market.



## Observations and findings

### Approval of AQUA product issuers and admission of AQUA ETPs to trading status

- 90 ASX has a well-documented, risk-based process for the assessment of applications for AQUA ETP admission. Initial review of AQUA ETP applications by the Investment Products onboarding team results in each product application being defined as either 'standard' or 'non-standard'. For each non-standard ETP application, a meeting of the Investment Products Panel is convened to bring together staff from Listings Compliance, Investment Products, ASX Legal, and any other ASX staff who ought to be consulted. In practice, this working group appeared to assist significantly with robust identification and discussion of relevant issues and matters before the final review of the application and any decision made by Listings Compliance on whether to approve the issuer and/or admit the product.
- 91 Noting that updates were made to relevant policies and procedures during the assessment period as part of the Investment Products Work Plan, we found high levels of consistency between the way ASX staff discharged their duties in practice, and ASX's documented policies, processes and procedures. The Investment Products Work Plan also resulted in a series of improvements to AQUA application forms for use by prospective issuers, and a range of corresponding checklists and other templates used by ASX in assessing applications.
- 92 Despite the above, some elements of ASX's arrangements raised regulatory concerns from a structural and process perspective. One theme that is reflected in many of our findings below relates back to our earlier observations about the importance of robust internal review and continuous improvement. When new rule books or markets are established, arrangements will naturally 'grow up' and mature with the business. These arrangements should be periodically reviewed to ensure they remain fit for purpose and aligned with regulatory obligations.

### The split of admission work between the Listings Compliance and Investment Products onboarding teams

- 93 As part of the Investment Products Work Plan, ASX undertook a validation of the split of admission work between Listings Compliance and the Investment Products onboarding team.
- 94 Following ASX's validation exercise, no significant changes were recommended to the existing AQUA admission arrangements. There was one notable improvement to the admission process connected with this item—the engagement of a dedicated Investment Products Compliance Manager to take over the AQUA admission review and supervision work that had



previously been shared among a pool of specified listing advisers. However, this change did not substantially alter the division of work between the two teams.

- 95 For reasons which we will step through in some detail below, we are not convinced that ASX thoroughly considered the appropriateness of all aspects of the current admission process with reference to its regulatory obligations as a market licensee.

*Comparison of the AQUA and listed equities admission processes*

- 96 The AQUA admission process is unlike ASX's admission process for listed equities. Listed company admissions are predominantly focused on a legal assessment of whether the application complies with the rule requirements. In contrast, AQUA ETP admissions should also assess other nuances, including the structural aspect of whether it is appropriate for the proposed investment strategy to be admitted as an ETP—as opposed to an unlisted investment product able to be settled through ASX's managed fund settlement service (mFund) or listed investment company (LIC), as well as operational issues such as the proposed approach to fulfil liquidity provision or market-making requirements in the AQUA rules.
- 97 There may be principled reasons to maintain a difference between the listed equities and AQUA admission processes. However, ASX's current arrangements for AQUA admissions appear to have arisen out of historical practice rather than in accordance with a plan. In practice, we observed that although Listings Compliance has the final say on all admission decisions for AQUA ETPs, the Investment Products onboarding team (sometimes referred to as the 'business development' or 'BD' team) has a very high level of influence over important stages in the AQUA ETP admission review process.
- 98 The Investment Products onboarding team brings significant and valuable experience, insight and knowledge to the AQUA admission process. However, we have formed the view that the appropriate level of involvement of this team in the formal admission process should be reconsidered in light of the team's broader roles and responsibilities and current KPIs. Alternatively, ASX could adjust its approach to those other arrangements to support this team's continued involvement in Steps 1 and 2 of the AQUA ETP admission process: see Figure 1 and Appendix 2 for further information about the steps in ASX's AQUA admission process.

*The broader role of the Investment Products onboarding team*

- 99 The Investment Products onboarding team is usually the first point of contact at ASX for AQUA product issuers. This team is responsible for ongoing relationship management and facilitating a positive customer experience with ASX for those entities.

- 100 Investment Products onboarding staff typically have both 'Licence to Operate' and 'Growth Initiatives' goals cascaded via ASX's VSE framework. In the assessment period, this included a growth target for investment products—across LICs, listed investment trusts (LITs), ETPs and mFund. Investment Products and Listings Compliance staff shared common 'Licence to Operate' goals including work to identify and implement improvements to AQUA compliance processes (i.e. the gap analysis and Investment Products Work Plan).
- 101 All the ASX staff we interviewed were aware that ASX's ability to operate the AQUA market is predicated on the maintenance of its market licence, making the achievement of 'Licence to Operate' goals paramount. To support this, we understand that ASX recently developed online training to ensure that staff understand key market licence obligations. ASX has also planned improvements to risk management systems to monitor compliance with market licence obligations more closely.
- 102 Investment Products onboarding staff conveyed clearly to us that since they do not have the power to make the final decision on AQUA admissions, there is no direct conflict between their growth goals and their role in the admission process. We consider that even if no direct conflicts arise as a result of these staff members having an incentive to grow and develop the market, there are almost certainly potential or perceived conflicts associated with such arrangements based on our observations of this process in practice.

*Pre-application discussions with issuers*

- 103 Unlike issuers of listed equities, AQUA product issuers can apply for admission of multiple products to trading status on the market. In this context, AQUA product issuers typically build an ongoing relationship and maintain regular contact with ASX in connection with their existing admitted products, and to pitch ideas for new products they might seek to have admitted in the future.
- 104 ASX's policies and procedures for the admission of AQUA products do not currently clarify the extent to which it is appropriate for staff in the Investment Products onboarding team to be involved in guiding or helping issuers to navigate the AQUA admission process in the pre-application stage and during the formal application review process. In practice, we observed that guidance to issuers might include ASX making suggestions for improvements to an application, or indicating which parts of an application might be likely to fail during ASX's detailed review process. The Investment Products staff we interviewed viewed this as a key strength of the current process for AQUA admissions.

- 105 In cases where an Investment Products onboarding team member makes substantive suggestions to an issuer pre-application, we are of the view that it is inappropriate for the same team member to also conduct the initial review of the application and provide an assessment or recommendation to the Listings Compliance team or Investment Products Panel.
- 106 We also identified a need for greater discipline and clarification of expectations around communications and interactions between Investment Products onboarding staff and prospective issuers during the formal AQUA application process. In particular, views on the success of an application should not be communicated to prospective issuers while ASX committees or Listings Compliance are still actively considering that application.
- 107 It was brought to our attention during the assessment that ASX could develop new and updated guidance notes to help AQUA product issuers understand ASX policies and processes, including more detailed guidance on the admission process. We strongly support the development of more standardised and comprehensive guidance to help prospective issuers navigate the AQUA rules. This may potentially reduce the need for the Investment Products onboarding team to get closely involved in pre-application discussions with issuers.

*Listings Compliance restructure and co-location with business development*

- 108 In pursuit of a VSE goal related to optimisation of the listing business operating model, ASX's Listings Compliance team was restructured in the second half of 2018. Following the restructure, Listings Compliance was also physically co-located with the Listings and Issuer Services business development team (which includes Investment Products onboarding and sales staff). We viewed this co-located working area during our site visit of ASX in September 2019.
- 109 We were briefed on the Listings Compliance restructure and co-location before ASX made the changes, and at the time we raised no objections. Based on more detailed material reviewed as part of this assessment, our concern in hindsight is that there were some aspects of ASX's rationale and implementation of this change that we found difficult to reconcile with its commitment to the regulatory principles underpinning its 'Licence to Operate'.
- 110 Information we reviewed during our assessment suggested a broader goal of 'alignment of Business Development and Compliance functions' and 'optimisation of decision-making' as a result of the co-location. To some degree, this messaging undermines the strict separation of duties that is required in order to manage conflicts in the AQUA admission process.
- 111 Further, in relation to implementation of the co-location, affected staff were provided with general online training on conflicts (common to all ASX staff). However, we saw no evidence that any specific assessment of

conflicts management associated with the co-location was performed, or that any tailored guidance was issued to staff in connection with this change.

- 112 Subsequent to the assessment period, ASX introduced a new policy on managing regulatory conflicts. This policy makes it clear that Listings Compliance admission decisions should be based solely on the requirements and underlying principles of the relevant market operating rules and the reputation and integrity of the ASX market. We remind ASX that in order for a policy to be effective, it is essential that it is supported by the broader strategy and an organisation's arrangements in practice.

*Management of conflicts related to AQUA ETP admissions*

- 113 In theory, the potential or perceived conflicts in ASX's AQUA ETP admission model are managed by Listings Compliance performing the final review of all AQUA applications and making an independent decision on whether or not to approve an AQUA product issuer or admit a product to quotation.
- 114 In practice, under current arrangements, we found that the Investment Products onboarding team has a high degree of influence over the admission process. This influence is derived from their ability to potentially shape or influence the way an issuer frames certain issues in its application, and subsequently make recommendations on the same issues through their initial assessment of an application before it goes to Listings Compliance for review. This level of influence appears likely to increase based on broader strategic drivers (including those behind the co-location of the two teams).
- 115 We observed that members of the Investment Products onboarding team at times displayed a high degree of confidence that their initial assessment or recommendation to Listings Compliance or the Investment Products Panel would not be challenged through the resulting stages of the admissions process. In one example we sighted, this view was even conveyed to an issuer before a meeting of the Investment Products Panel.
- 116 Listings Compliance staff we interviewed were aware that they should perform their final review of applications independently and diligently before making a final decision (including verifying the work of the Investment Products onboarding team). However, they also displayed high levels of trust in the judgement of their Investment Products colleagues. It appeared to us that the Listings Compliance team were not always fully aware of the nature or frequency of discussions and related correspondence between the Investment Products onboarding team and the prospective ETP issuers, including which specific issues may have already been discussed before and during the application process.

### Investment Products Panel composition, terms of reference and record-keeping

- 117 The Investment Products Panel is a working group that is convened whenever ASX reviews a 'non-standard' AQUA product application. Given the important contribution of this working group to the robustness of the AQUA admission process, aspects of ASX's arrangements relating to the Investment Products Panel could be documented more clearly.

Note: See Appendix 2 for a more detail discussion about what might constitute a 'non-standard' AQUA product application.

- 118 The attendees for Investment Products Panel meetings are usually the same staff who review and ultimately approve AQUA admissions at an operational level. Consistent with our observations in Section B that the low profile of this market segment had a negative impact on development of governance and strategy, there may be significant benefit if more senior ASX staff and executives were to attend these meetings on a regular basis. This would increase robustness of the process through the provision of independent perspectives, advice and guidance, and foster greater awareness of emerging risks and issues throughout the organisation.
- 119 Currently, a description of the types of issues or matters to be considered by the panel, its standing invitees, and a brief summary of its role and processes are included in ASX's procedures for the admission of warrants and AQUA products. Although we were able to learn more about the operation of the Investment Products Panel through interviews, it would be better practice if ASX recorded some additional information about how this panel works in practice—for example, either by adding to the existing procedure or through a separate charter document.
- 120 The papers that go to each Investment Products Panel meeting are in a standard form. One minor drawback associated with this practice is that the form does not always clearly identify which issues the panel should focus on. This, in combination with the fact that no formal minutes are taken at Investment Products Panel meetings, means that there is presently a gap in ASX's formal record-keeping.
- 121 According to ASX's procedures, a 'Record of Decision' is prepared after the meeting by the Investment Products onboarding team and approved by Listings Compliance after each Investment Products Panel meeting. This document is a good summary of the panel's decision or conclusion, but does not typically provide adequate information on how the panel's conclusions were reached. More detailed information was generally captured in informal emails circulated by ASX staff following Investment Products Panel meetings. This level of detail should form part of ASX's formal records of Investment Products Panel meetings.

### **Appropriate reliance on precedent**

- 122 Over time, market operators with an admission function will build up a body of internal policy based on previous assessments and decisions. This will generally also include legal advice and other supporting documentation considered in making those decisions—all of which should be duly recorded so the market operator can demonstrate compliance with their licensing obligations: see RG 172.149–RG 172.151.
- 123 When relying on precedent, it is important to do so in an appropriate manner. During our assessment, we became aware of a small number of instances where ASX staff had not been as diligent as they could have been in tracking a precedent down to its original source. The fact that an ETP previously admitted to the market had a certain feature or characteristic does not necessarily indicate that ASX specifically considered that feature during that product's admission assessment.
- 124 Even if ASX did consider a particular feature or characteristic during its original assessment, it may have considered it in conjunction with other features or characteristics not present in the later application, potentially limiting the relevance or applicability of that prior decision. The market may also have evolved since the original decision, and the appropriateness of that feature or characteristic would need to be re-assessed, including with regard to ASX's AQUA strategy and risk appetite.

### **Supervision of AQUA ETP issuers**

- 125 Monitoring and enforcing compliance with market operating rules is a key obligation of market licensees under s792A(1)(c)(ii) of the Corporations Act. As indicated in RG 172.128, the types of arrangements a market venue will require to meet this obligation will depend on the nature of the venue, the financial products traded on the venue and the participant conduct being monitored.
- 126 Our main finding in this area is that, perhaps as a result of the relatively fast growth of the AQUA ETP market in recent years, ASX's arrangements for monitoring and enforcing compliance with the AQUA rules have not kept pace with the increasing size and sophistication of this market. A range of improvements were initiated during the assessment period to rectify this. Some of these improvements had a direct relationship to recommendations in REP 583, while others were of a more general nature. In some cases, improvements have involved ASX translating good practices from its listed equities compliance area to AQUA through enhancements to tools and systems.

### **Responsibility for monitoring and enforcing compliance with the AQUA rules**

- 127 Responsibility for monitoring and enforcing compliance with the AQUA rules sits with Listings Compliance; however, it is supported by the work of the Investment Products onboarding team in some respects.
- 128 ASX's decision to create a dedicated role for investment products (including AQUA) compliance has positively contributed to its ability to monitor and enforce the AQUA rules. Although there is 'key person risk' associated with this structure (see Section D), the practical benefits from a monitoring and compliance perspective include greater consistency, accountability, and more focus on this area than under the previous arrangements, noting that the AQUA rules are separate from the ASX Listing Rules.
- 129 When interviewed, ASX's Investment Products Compliance Manager was able to point out a range of minor improvements that had already been made to monitoring and compliance processes, as well as plans and ideas for improvement in the future (including potential risk-based or thematic reviews of issuer compliance, for example, to assess adherence to an investment mandate). What was less clear, from the interviews we held with ASX staff more broadly, was the extent to which the growth of this function had been planned or mapped out to accommodate these further improvements.

### **More active AQUA compliance monitoring**

- 130 One of our key concerns prior to the assessment period was that ASX was relying too heavily on attestations from issuers to verify compliance, and was not doing enough active monitoring of its own to ensure compliance with the AQUA rules. Consistent with our stated expectations from REP 583 and other correspondence with ASX, ASX took steps during the assessment period to enhance its supervision of the AQUA market.
- 131 To some extent, ASX still relies on annual attestations from issuers as one means of confirming compliance with its AQUA rules. However, through the Investment Products Work Plan, ASX has now supplemented these attestations with the introduction of a range of more formal procedures that involve ASX more proactively checking and confirming that issuers are complying with key obligations under the AQUA rules.
- 132 After the assessment period, ASX implemented significant improvements to its compliance monitoring systems to capture activities in relation to AQUA products and issuers. This work involved leveraging systems that had previously only been configured for listed equities compliance activities.



*ETP liquidity and spread monitoring*

- 133 REP 583 contained recommendations for market operators related to ongoing supervision of the ETP market's liquidity: see REP 583 at paragraph 114. ASX has commenced work to address gaps in its supervisory practices but has not yet fully implemented our recommendations.
- 134 Historically (including at the start of the assessment period), ASX monitored spreads and performance of market makers on a quarterly, retrospective basis, and published average spread data for each ETP on a monthly basis. Investment Products staff compiled relevant data from an external provider and reported it to Listings Compliance on an 'exceptions' basis every quarter (i.e. only to highlight potential non-compliance, which the Listings Compliance team might investigate in further detail).
- 135 This arrangement had several disadvantages, including that it involved manual processing, created a significant time lag between non-compliance and potential compliance action, and little flexibility (e.g. for Listings Compliance to request data on a more regular basis if needed). We did not see evidence of strong accountability between the two teams for the timing of these reports and analysis. In addition, since Listings Compliance staff were not interrogating the full dataset themselves, there was a risk that broader trends or themes may have been missed.
- 136 During our assessment, we found that ASX's arrangements to monitor spreads and performance of market makers on a quarterly, retrospective basis were not always effective in practice. In one example, we brought to ASX's attention that market-making requirements did not appear to have been met for a specific ETP over a period of months. Although we have no concerns about how this matter was handled after it was raised with ASX, ASX's own systems and processes should have been able to identify the initial trigger to investigate and enforce compliance with its operating rules.
- 137 During the assessment period, ASX initiated work to develop improved systems and tools for ETP liquidity monitoring. Although this work was originally intended to be completed in 2019, ASX has advised us of delays to the development and implementation of these new systems and tools. This raises some concerns about ASX's commitment and capacity to meet regulatory expectations in a timely manner.
- 138 Once the work is complete, ASX will be able to more promptly address instances of insufficient market-making activity with an ETP issuer and its market maker, and consider whether trading in the affected product should be halted until the issue has been resolved. As confirmed during our site visit in September 2019, ASX is currently able to monitor ETP liquidity on a daily basis using a proof-of-concept version of the tool being developed for this purpose—a significant improvement on its previous monitoring practices.



### Reporting and oversight of AQUA ETP monitoring and compliance activities

- 139 As noted above in relation to AQUA market strategy, risk and governance, AQUA monitoring and compliance activities have historically not been very visible to senior management. We understand that the expectation was that any significant findings would be reported upwards—but it does not appear that management took much active interest in monitoring or guiding this work.
- 140 During the assessment period, we observed notable improvement to the visibility and profile of AQUA ETP compliance issues due to the appointment of a dedicated Investment Products Compliance Manager, improvements to systems, and as a result of ASX's recent experience addressing a serious example of non-compliance that resulted in removal of the product from quotation.

## Recommendations

- 141 Table 2 sets out a summary of our findings and recommendations in relation to ASX's arrangements for operating the AQUA market.

**Table 2: Arrangements for operating the AQUA market—findings and recommendations**

Findings	Recommendations
<p><b>ASX needs to review its AQUA admission process holistically with other related arrangements to reduce conflicts</b></p> <p>ASX's arrangements for the approval of AQUA product issuers and admission of AQUA ETPs to trading status appeared to be adequate in terms of supporting robust admission outcomes. However, we have some significant concerns about the current split of AQUA ETP admission work between Listings Compliance and the Investment Products onboarding teams.</p> <p>In practice, the Investment Products onboarding team has a very high level of influence over important stages in the AQUA ETP admission review process. However, the expectations and frameworks around this team (including the broader role of the team, KPIs and goals) are not consistent with their current role in the process or regulatory expectations. The current combination of arrangements has the potential to undermine the integrity of the admission process.</p>	<p>ASX should re-validate the current split of AQUA ETP admissions work between the Listings Compliance and Investment Products onboarding teams and develop a roadmap for strengthening its arrangements in both the short and medium term.</p> <p>Specifically, ASX should review and clarify its expectations concerning:</p> <ul style="list-style-type: none"> <li>• involvement of the Investment Products onboarding team in helping issuers to 'navigate' the admission process in the pre-application stage; and</li> <li>• appropriate communications with issuers while an application is under consideration. Once an application has been formally lodged with ASX, ASX should consider whether communications should occur directly between Listings Compliance and the issuer, rather than continuing to occur via Investment Products onboarding.</li> </ul>

Findings	Recommendations
<p>ASX's policies and procedures for the admission of AQUA products do not currently clarify the extent to which it is appropriate for staff in the Investment Products onboarding team to be involved in guiding or helping issuers to navigate the AQUA admission process in the pre-application stage and during the formal application review process.</p>	<p>Depending on what ASX decides in relation to the above, some combination of changes will also be required, including:</p> <ul style="list-style-type: none"> <li>• updating AQUA admission policies and procedures. If necessary, this should include re-allocation of steps in the AQUA application review process to ensure independent review and assessment of applications for admission;</li> <li>• amending cascaded VSE goals and KPIs for Investment Products onboarding staff (i.e. those with a direct role in initial review of AQUA ETP applications); and</li> <li>• developing more formal guidance for issuers about the admission process. In this regard, we encourage ASX to adopt or integrate practices from its listed equities area, where detailed guidance notes exist across a much wider range of topics than for AQUA.</li> </ul>
<p><b>ASX should take greater care to ensure that the independence of the Listings Compliance team is supported by adequate arrangements in practice</b></p> <p>Listings Compliance and Listings and Issuer Services were co-located during the assessment period. We observed shortcomings in ASX's messaging around, preparation for and management of this change.</p>	<p>We expect ASX to review and validate that current arrangements to manage any risks or conflicts specifically connected with the co-location of these two teams are adequate.</p> <p>This may require clearer communication to affected staff about how independent decision-making related to regulatory obligations is being preserved under current arrangements (i.e. how practice supports the policy).</p>
<p><b>There are opportunities to improve the composition, documentation of arrangements and record-keeping in relation to the Investment Products Panel</b></p> <p>The Investment Products Panel is an important working group that contributes significantly to the robustness and integrity of the AQUA ETP admission process. Aspects of ASX's arrangements related to the panel could be documented more clearly.</p> <p>There may be significant benefit if more senior ASX staff and executives were to attend these meetings on a regular basis. This would increase the robustness of the process through the provision of more independent perspectives, advice and guidance, and foster greater awareness of emerging risks and issues throughout the organisation.</p>	<p>ASX should record (either within the existing procedures document or in a separate 'terms of reference' or charter document) the following additional information about the function of the Investment Products Panel:</p> <ul style="list-style-type: none"> <li>• minimum requirements for panel composition and operation (noting that in practice many of the standing invitees do not attend on a regular basis);</li> <li>• decision-making (which appears to occur by consensus in practice); and</li> <li>• minimum requirements for record-keeping (see below).</li> </ul> <p>ASX should ensure that more fulsome details of issues discussed at Investment Product Panel meetings are recorded, either by introducing formal minutes, mandating that further information should be captured in the Record of Decision, or making the informal emails circulated by ASX staff following panel meetings part of the required procedures for these meetings. This will help to ensure that corporate memory is more robustly preserved for the future.</p>

Findings	Recommendations
<p><b>Care must be taken when relying on precedent</b></p> <p>During the AQUA ETP admission review process, it appeared that ASX staff, in a small number of cases, had not been as diligent as they could have been in tracking a precedent that was being relied on back to its original source.</p>	<p>ASX staff responsible for reviewing AQUA ETP applications and making assessments as to the admissibility of new products should remain alert to this issue.</p> <p>Where relevant, this may also include requesting support from ASX Legal.</p>
<p><b>ASX engaged a dedicated Investment Products Compliance Manager during the assessment period</b></p> <p>This is a good example of a market operator taking steps to improve arrangements, consistent with the changing size and features of the relevant market. This has resulted in a number of practical benefits for ASX from a monitoring and compliance perspective.</p>	<p>ASX should plan the growth of this function and consider how to accommodate further improvements to monitoring and enforcing compliance with the AQUA rules.</p> <p>We strongly encourage ASX to consider the creation of this role as a first step, rather than the end of its improvement efforts in this area.</p>
<p><b>ASX took steps during the assessment period to enhance active monitoring and supervision of the AQUA market</b></p> <p>Subsequent to the assessment period, ASX implemented significant improvements to its compliance monitoring systems to capture activities in relation to AQUA products and issuers.</p>	<p>ASX's most recent update to its Investment Products Work Plan (due to be completed in June 2020) indicates there is further work to be done in this area.</p> <p>We strongly encourage ASX to complete these outstanding items in a timely way, and also consider what other improvements could be made to ongoing monitoring of compliance with its AQUA rules in future.</p>
<p><b>ASX has not yet fully implemented recommendations from REP 583 related to liquidity monitoring</b></p> <p>During the assessment period, ASX initiated work to develop:</p> <ul style="list-style-type: none"> <li>new surveillance alerts to generate notifications to ETP issuers and market makers where there is no bid or offer for a prescribed period; and</li> <li>a new system to monitor whether market makers are complying with liquidity requirements on a daily basis and generate alerts when they are not.</li> </ul> <p>We are concerned that there have been delays to the completion of this work, raising questions about ASX's commitment and capacity to meet regulatory expectations in a timely manner.</p> <p>ASX has not yet fully met regulatory expectations in this area; however, we expect they will do so once their new market maker monitoring and alert systems 'go live'.</p>	<p>This work must be prioritised to ensure ASX meets regulatory expectations.</p> <p>ASX's improvements to liquidity monitoring (currently in the process of being implemented) should be completed as soon as practicable in order to meet regulatory expectations.</p>
<p><b>The visibility of AQUA market monitoring and compliance activities could be further improved</b></p> <p>There has recently been notable improvement to the visibility and profile of AQUA ETP compliance issues as the result of the appointment of a dedicated Investment Products Compliance Manager, improvements to systems, and ASX's recent experience addressing an example of non-compliance.</p>	<p>We encourage ASX to continue its work to identify gaps and implement stronger and more formal monitoring, reporting, accountability and oversight mechanisms for the AQUA market.</p> <p>This will ensure that AQUA compliance activities are completed in a timely way, and that trends, risk and issues are better understood and adequately considered by management.</p>

## D Resourcing the AQUA market

### Key points

Market licensees are required to have sufficient resources to operate the market venue properly. From a human resources perspective, what is 'sufficient' will depend on the nature, size and complexity of the venue.

There was significant strain on human resources dedicated to the AQUA market throughout the assessment period. This affected ASX's ability to meet specific regulatory expectations.

ASX needs to consider how it can build more flexibility into its current resourcing arrangements to better manage peaks in workload.

### Overview

- 142 The requirement for a market operator to have sufficient resources (including financial, technological and human resources) to operate the market properly is set out in s792A(1)(d) of the Corporations Act.
- 143 From a human resourcing perspective, what constitutes 'sufficient' resourcing will depend on the nature, size and complexity of the venue. As market venues and operators' businesses may change over time, a licensee should keep under review whether it still has sufficient human resources, including the right balance of skill sets: see RG 172.104.
- 144 The 'Principles for resourcing' contained in Appendix 1 of RG 172 state that operators of listing markets should have sufficient resources available at all times. The market operator must allocate sufficient resources not only to the administration of the rules (admissions, monitoring and enforcement), but also to resourcing that supports a broader range of work, including:
- (a) evaluating the suitability of business models;
  - (b) evaluating wider suitability for listing issues;
  - (c) challenging, where appropriate, listee boards and executives on compliance with the substance, spirit, intention and purpose of the listing rules;
  - (d) evaluating the appropriateness and effectiveness of any enforcement action, and having a sound basis for selecting the chosen approach; and
  - (e) proactively anticipating risks and changes in the operating environment, and dealing with them in a timely and effective manner.

Note: See RG 172.484–RG 172.485.

- 145 Although these 'Principles for resourcing' were drafted specifically for operators of listing markets, we have similar expectations for market operators that admit ETPs to trading status.
- 146 For the purposes of this assessment, we focused on ASX's allocation of human resourcing to the AQUA market. In this area, human resourcing has a reasonably direct relationship with allocation of financial resourcing to the market. As noted above, the technology and related arrangements underpinning the AQUA ETP market are common to the broader ASX market for equities. Specific and detailed consideration of technology-related resourcing was excluded from the scope of this assessment.
- 147 In our consideration of adequate human resourcing of the AQUA market, we primarily considered the resourcing of the AQUA admission process, including how well ASX was able to respond to regulator requests for information during the assessment period, and the availability of resources for conducting compliance monitoring arrangements.

## Observations and findings

### Allocation of resourcing to the AQUA market

- 148 ASX staff we interviewed during our assessment were knowledgeable, experienced and dedicated to their work. We observed a constructive and collegiate attitude to cross-team work and communication, as well as a sense of shared purpose consistent with ASX's vision and core values.
- 149 However, we also observed signs of strain on AQUA market resourcing during the assessment period related to workload. ASX took some steps to address this during and after the assessment period but—in relation to the Investment Products onboarding team in particular—we consider that ASX could reasonably have acted sooner to relieve the sustained pressure on its staff.

### Listings Compliance

- 150 In the Listings Compliance team, the Investment Products Compliance Manager is currently working part time (0.8 full-time equivalent or 'FTE') and is supported by a paralegal, as needed. The General Manager, Listings Compliance also regularly allocates time to AQUA market matters, while the Chief Compliance Officer generally only spends a small proportion of time on AQUA in the ordinary course of business.
- 151 It is difficult to judge whether the decision to engage a dedicated Manager Investment Products Compliance has resulted, overall, in more or less time spent on the AQUA market compared to the previous arrangement (a pool of

Listings Compliance resources working on AQUA issues in addition to their other duties). Nevertheless, as noted above, this change has clearly resulted in a number of benefits for ASX, including improved communications between Listings Compliance and Investment Products, and enhanced focus, accountability and commitment to AQUA-specific matters and issues.

152 During our assessment, we observed some preliminary indicators of resourcing stress in the Investment Products Compliance function, primarily associated with the implementation of the Investment Products Work Plan. Based on the current staffing of this function, this no doubt had a direct flow-on impact on capacity available for other compliance monitoring activities.

153 To the extent there is capacity and expertise within other parts of Listings Compliance to assist, ASX may not need to address this immediately. However, we have recommended that ASX focus more on continuous improvement—and the implementation of other recommendations in this report may also fall to the Investment Products Compliance function. For these reasons, ASX's management team should closely monitor workloads to determine whether any stress in the new Investment Products Compliance function is persistent. We anticipate that resourcing levels will likely need to be adjusted to ensure ASX is able to implement our recommendations without compromising other compliance activities.

### **Investment Products**

154 During the assessment period, ASX's Investment Products onboarding team had three FTE staff working on AQUA admissions (including ETPs and mFund). In addition, the Head of Investment Products split their time close to evenly between oversight of 'customer onboarding' (initial review and assessment of AQUA applications) and other responsibilities. The Executive General Manager, Listings and Issuer Services spent little time specifically dedicated to AQUA market admission work but did liaise with AQUA product issuers.

155 We observed a number of significant markers of resourcing stress in the Investment Products onboarding team in the material we reviewed for our assessment. We understand that, to some extent, ASX was aware of this stress and, after the assessment period (on 1 July 2019), increased the resourcing of this team by one FTE team member.

156 Unlike the Listings Compliance team, which has more flexibility to involve other team members to relieve resourcing pressure when required, it does not appear that this is done in the Investment Products team to the same extent. In part, this may relate to the fact that the skills and experience required to perform reviews of applications for AQUA ETP admissions are highly specialised. Nevertheless, we have concerns that, for a period of at least

12 months, the Investment Products onboarding team was known to be under-resourced and very little was done to alleviate this issue in the interim.

157 We observed that this strain created a challenging work environment for the affected staff, whose dedication to their work despite the pressure was notable. In future, and subject to any changes ASX may choose to make to its AQUA ETP admission process as a result of our earlier recommendations, we expect ASX to develop strategies to more effectively cover even a temporary surge in admission activity to prevent undue pressure being put on its staff.

#### **Other teams at ASX**

158 Ensuring that there are sufficient resources allocated to operate the market is not limited to Line 1 resourcing. It also includes ensuring that there is sufficient or adequate support staff in all relevant areas to ensure the market is operated properly.

159 Although more specific consideration of the adequacy of resourcing in these areas was beyond the scope of our review, ASX should be aware that our comments below—related to monitoring and assessment of adequate resourcing to fulfil market licence obligations—are not restricted to only Listings Compliance and Investment Products onboarding staff.

#### **Monitoring and assessment of adequate resourcing**

160 Our general observation about monitoring and assessment of adequate resourcing is that ASX presently lacks sophisticated frameworks for this purpose.

161 The Chief Compliance Officer regularly signs a formal declaration to the ARC that resourcing in the Listings Compliance team is sufficient. However, it did not appear to us that there was any structured, formal monitoring behind this declaration. During our assessment, we were not made aware of any other relevant functions within ASX that make similar declarations.

162 In general, the ASX executives we interviewed did not appear to have any formal triggers for when they might consider resourcing insufficient. Sometimes this was limited to visual observations around the office of who was consistently working longer hours. As noted above, sufficient resourcing for the purposes of satisfying market licence obligations should be assessed with reference to the ability to operate the venue properly, and should not only include consideration of those staff with a direct role in helping ASX monitor and enforce compliance with its operating rules.

163 Before and during the assessment period, we made some requests of ASX to complete AQUA-related research and other review work. These tasks were consistent with our broader expectations of market operators with an



admission function. In relation to one piece of work, we requested ASX to benchmark its rule frameworks for ETPs against those of other major jurisdictions. However, ASX was unable to complete our request within a reasonable timeframe, taking almost two years to deliver a summary of the work completed. We were also made aware that gathering information for the purposes of our assessment put significant stress on the same ASX resources involved in operating the AQUA market.

164 Market operators have a range of obligations to assist ASIC, including an obligation to provide reasonable assistance in connection with the performance of our functions under s792D of the Corporations Act.

165 ASX needs to consider how to better manage its resourcing to ensure it has capacity to address a broader range of work linked to its role as a gatekeeper for the AQUA market, as well as regular requests for information related to the operation of its markets and other licensed activities. The lean nature of ASX's workforce likely contributed to some of the delays in implementing improvements that we have described throughout this report.

### **Key person risk**

166 The work done by ASX staff in operating the AQUA ETP market is highly technical and specialised. At present, since only a short amount of time has passed since the Listings Compliance restructure, there is flexibility in this team to reallocate resourcing to cover temporary increases in workload related to the AQUA market. Over time, however, as AQUA compliance processes and systems develop, mature and become more sophisticated, there is an increased risk that close working knowledge of these processes and systems will become siloed in the Investment Products Compliance Manager function.

167 Similarly, in the Investment Products onboarding function, we observed that there is very significant reliance placed on the judgement and knowledge of the Senior Manager, Investment Products Onboarding. There is also an absence of formal guidance, processes or other documentation to record or capture elements of this expertise at the corporate level.

168 Building some additional capacity into these functions would likely facilitate the continuous improvement work and other regulatory assistance that appears to have strained resourcing during the assessment period. This will also ensure that ASX extracts more value from highly skilled staff if their knowledge and experience can be passed on to others. Since it may be difficult for market operators to find directly relevant skills and expertise externally, building up talent pools internally and ahead of time may be a more appropriate solution.



## Recommendations

169 Table 3 sets out a summary of our findings and recommendations in relation to ASX's resourcing of the AQUA market.

**Table 3: Resourcing of the AQUA market—findings and recommendations**

Findings	Recommendations
<p><b>ASX needs to monitor human resourcing more closely, and act to address strain</b></p> <p>ASX took some steps during and after the assessment period to address stress on human resourcing related to operating the AQUA ETP market.</p> <p>However, we anticipate that resourcing levels will likely need to be adjusted to ensure ASX is able to implement our recommendations without compromising other compliance activities.</p>	<p>As noted above, the growth of the Investment Products Compliance function needs to be planned in further detail—this should include close monitoring of workloads over six to 12 months to ensure that the new function is resourced adequately, including in light of the recommendations in this report.</p> <p>Subject to any changes ASX makes to the AQUA ETP admission process, ASX should review its arrangements for the Investment Products onboarding team and develop strategies to more effectively cover even a temporary surge in admission activity to prevent undue pressure being put on its staff.</p> <p>Consideration should also be given to whether resourcing of relevant support functions (Legal, Compliance, Risk) is sufficient in all circumstances.</p>
<p><b>ASX presently lacks sophisticated frameworks for monitoring and assessing adequate resourcing</b></p>	<p>ASX should develop more structured frameworks for assessing adequacy of resourcing across relevant areas of its business. This might include:</p> <ul style="list-style-type: none"> <li>• a more structured and formal monitoring process behind executive declarations of sufficient resourcing;</li> <li>• consideration of whether a broader range of executives should assess and make formal declarations that resourcing in their areas is sufficient;</li> <li>• definition of appropriate indicators of resourcing stress, or trigger points to prompt reviews of the sufficiency of resourcing; and</li> <li>• more explicit recognition that sufficient resourcing includes the ability to address a range of regulatory requests for information and other compliance activities in a timely fashion, without putting undue strain on existing resources.</li> </ul>
<p><b>Key person risk</b></p> <p>We observed significant potential key person risks in both the Listings Compliance and Investment Products teams.</p>	<p>It would be prudent for ASX to consider expanding critical functions beyond what is strictly necessary to operate the market at a given time in order to 'future-proof' its market operations and manage key person risks.</p>

## Appendix 1: Growth of the Australian and global ETP markets

### Australian ETP market growth

- 170 In REP 583, we noted that the Australian ETP market grew from A\$25.63 billion as at 31 December 2016 to A\$35.69 billion as at 31 December 2017, representing an annual increase of 39.25% in funds under management.
- 171 As at 30 June 2019, ETP funds under management was A\$50.59 billion, representing an annualised increase of 27.83% in funds under management over the previous 18 months. Trading volumes also grew substantially from an average daily traded value of A\$146.44 million in December 2017 to A\$207.02 million in June 2019. The average number of transactions per day increased from 4,100 to 6,356 over the same period.
- 172 On 30 June 2019, there were 198 ETPs available on the ASX AQUA market, including 153 ETFs (of which three were synthetic ETFs), 39 managed funds and six structured products across 23 issuers. There were also 46 single asset corporate bond products, which are admitted as managed funds.

Note: Previously, ASX was the only market operator to admit ETPs in Australia. However, on 30 September 2019, Chi-X Australia announced the launch of the Chi-X Funds market, a competing offering to ASX's AQUA market. Chi-X Funds admitted its first ETP to quotation on 15 October 2019.

### Retail participation in the ETP market

- 173 REP 583 highlighted significant retail participation in the Australian ETP market, particularly from SMSFs. While SMSFs represented around 60% of the total ownership of ETPs, the share of self-directed investors and institutional investors was growing. This trend continues, with the [BetaShares and investment trends Australian ETF report](#) (March 2019) stating that 385,000 Australian investors held ETPs as at October 2018 (an increase of 23% over the previous year) with only 31% of this being through an SMSF. This represents a sizeable increase in institutional and self-directed investors in ETPs and shows the growing significance of this sector to Australian retail investors.

### Growth of ETPs globally

- 174 Investment in ETPs continues to grow globally, albeit at a slightly reduced pace compared to previous years. According to independent researcher ETFGI's [Global ETF and ETP industry insights: June 2019](#) report, as at 30 June 2019 there was approximately US\$5.64 trillion in funds under

management, which was an increase of about 17% over the previous 12 months. There were also 7,850 ETPs managed by 420 providers on 71 exchanges.

- 175 Regulators internationally continue to focus on the distinctive risks inherent in ETPs, including ETP structure, liquidity and complexity of some types of ETPs. A summary of the [key risks and characteristics of ETPs](#) can be found on ASIC's MoneySmart website.

## Appendix 2: The AQUA ETP admission process

### The AQUA rules, AQUA products and AQUA product issuers

176 Schedule 10A of the ASX Operating Rules contains the AQUA rules. The AQUA rules govern:

- (a) approval of AQUA product issuers;
- (b) admission of AQUA products; and
- (c) disclosure and other ongoing obligations of AQUA product issuers.

The terms 'AQUA product' and 'AQUA product issuer' are defined in the AQUA rules. These terms are not synonymous with ETPs and ETP issuers.

177 AQUA product issuers require approval from ASX before their products can be admitted to trading status, to the AQUA Quote Display Board or for settlement through mFund. AQUA products admitted to trading status are ETPs. AQUA products admitted to the AQUA Quote Display Board or for settlement through ASX's mFund service are not ETPs, as these products are not traded on the ASX market.

178 ASX can grant approval to an AQUA product issuer on a conditional basis, if it thinks it appropriate to do so. An AQUA product issuer's approval can be suspended or revoked by ASX for reasons that include non-compliance with conditions on its approval, or failure to abide by the market's operating rules.

### The AQUA ETP admission process

179 There are six steps in ASX's admission process for AQUA ETPs:

- (a) Step 1: Receipt and acceptance of application;
- (b) Step 2: Initial assessment by the Investment Products team;
- (c) Step 3: Consideration of non-standard products by the Investment Products Panel (and Regulatory Committee, if necessary);
- (d) Step 4: Detailed assessment and decision recommendation;
- (e) Step 5: Admission decision; and
- (f) Step 6: Implementation.

180 The admission process for AQUA ETPs primarily involves the following teams at ASX:

- (a) the Investment Products onboarding team is responsible for Step 1 and Step 2. This team plays a joint role with the Listings Compliance and ASX Legal teams in Step 3, and later facilitates Step 6 for successful applications. ASX's Investment Products area (comprised of two teams in total) is led by the Head of Investment Products and sits within the

broader Listings and Issuer Services team. This team is led by the Executive General Manager, Listings and Issuer Services;

- (b) the Listings Compliance team (which includes the Investment Products Compliance function) plays a joint role with the Investment Products onboarding and ASX Legal teams in Step 3, before taking responsibility for Step 4 and Step 5. This team is led by the Chief Compliance Officer; and
- (c) ASX Legal may be consulted as required at various points during the admission process, but has formal involvement at Step 3, together with the Investment Products onboarding and Listings Compliance teams.

181 At Step 2 of the admission process, the Investment Products onboarding team assesses whether an application should be characterised as 'standard' or 'non-standard'. Standard applications skip Step 3 of the process and proceed directly to Step 4. If, at Step 4, Listings Compliance determines that an application should have been characterised as 'non-standard', that application will be returned to Step 2 to be reprocessed as 'non-standard'.

Note: The assessment of a product as 'standard' or 'non-standard' is based on a set of objective criteria. For example, a non-standard product might have an unconventional product structure, investment strategy, underlying assets, disclosure arrangements and/or market-making approach.

182 For applications that involve a new issuer or have been assessed as 'non-standard' at Step 2, Step 3 may potentially also involve consideration of the application, or a matter connected with the application, by ASX's Regulatory Committee, following referral from the Investment Products Panel. An application will typically only be referred to the Regulatory Committee when it raises a significant new policy consideration.

Note: The Regulatory Committee is an ASX management committee, chaired by the ASX Group General Counsel and Company Secretary. Its other members include the Managing Director and Chief Executive Officer, Deputy Chief Executive Officer, Chief Compliance Officer, Chief Operations Officer and Chief Risk Officer of ASX.

183 Ultimately, the authority to decide whether to admit an ETP under the AQUA rules (Step 5) has been delegated to the Listings Compliance team within ASX Compliance.

184 ASX's Listings Compliance function has been delegated the responsibility by the ASX Group market and clearing and settlement licensees to act as their agent and representative to perform various compliance and enforcement services to help them satisfy their obligations under the Corporations Act. The importance of Listings Compliance maintaining a certain level of independence from other parts of ASX's business is underscored by the decision-making role this team plays in both listed equities and AQUA admissions.

185 The final step in the process, Step 6 'Implementation', refers to the finalisation of a series of processes required to set up the issuer and product in ASX's systems and admit the product to quotation.

## Appendix 3: Further information on assessment scope and methodology

- 186        Section 794C of the Corporations Act empowers ASIC to assess how well a market licensee is complying with any or all of its obligations. In doing the assessment, we may take account of any information and reports that we think are appropriate.
- 187        The general statutory obligations of market licensees are contained in s792A of the Corporations Act. Section 792A(1) provides that a market licensee must (among other obligations):
- (a)    to the extent that it is reasonably practicable to do so, do all things necessary to ensure that the market is a fair, orderly and transparent market;
  - ...
  - (c)    have adequate arrangements for operating the market, including arrangements for:
    - (i)    handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market operates in the way mentioned in paragraph (a); and
    - (ii)   monitoring and enforcing compliance with the market's operating rules; and
  - (d)    have sufficient resources (including financial, technological and human resources) to operate the market properly.
- 188        Specific exclusions from the scope of our assessment included:
- (a)    ASX's arrangements in respect of AQUA products admitted to the AQUA Quote Display Board or for settlement through mFund (i.e. AQUA products that are not ETPs); and
  - (b)    the technology and infrastructure supporting the market, as ASX's arrangements in this area were recently the subject of another ASIC review (see [Report 592](#) *Review of ASX Group's technology governance and operational risk management standards* (REP 592)).
- 189        In conducting our assessment of ASX, we considered:
- (a)    ASX's responses to our notices dated 5 February 2019, 25 February 2019 and 9 May 2019 issued under s30 of the *Australian Securities and Investments Commission Act 2001*;
  - (b)    information received during meetings and through correspondence with representatives from ASX's Human Resources and Finance teams;

- (c) information obtained through interviews held between June and August 2019 with ASX executives (Chief Compliance Officer and Executive General Manager, Listings and Issuer Services) and staff (General Manager Listings Compliance, Head of Investment Products, Senior Manager Investment Products Onboarding, Investment Products Compliance Manager, Senior Product Manager);
- (d) information obtained during a site visit to ASX's offices in September 2019; and
- (e) information obtained from and about ASX in the ordinary course of our dealings with it as a market licensee (including AQUA-related information contained in quarterly submissions ASX sends to ASIC).

190       The assessment period (i.e. the period under review) was 1 January 2018 to 5 February 2019 (the date we issued the first s30 notice to ASX). The assessment took place between February and September 2019.

191       In compiling this report, we also considered information that ASX created outside the assessment period and provided to us during our assessment. This generally related to areas where ASX took steps to implement improvements to its policies, procedures and other arrangements in the time between the assessment period and the finalisation of this report.



## Key terms

Term	Meaning in this document
AQUA market	ASX Quoted Assets market—the market segment or rule framework created by ASX to specifically manage the admission of ETF securities, managed fund products and structured products (collectively referred to as 'AQUA products') on the ASX market and to provide access for AQUA product issuers to clearing and settlement services provided by ASX Group
AQUA product	AQUA products are managed fund products, ETF securities or structured products as defined in ASX Operating Rule [7100]
AQUA product issuer	Has the meaning given in Schedule 10A of the ASX Operating Rules
AQUA rules	Schedule 10A of the ASX Operating Rules
ASIC	Australian Securities and Investments Commission
assessment period	1 January 2018 to 5 February 2019
ASX Group	The ASX group of companies including: <ul style="list-style-type: none"> <li>• ASX Limited</li> <li>• ASX 24—the licensed derivatives exchange market operated by Australian Securities Exchange Limited</li> <li>• ASX Clear—the licensed clearing and settlement facility operated by ASX Clear Pty Limited</li> <li>• ASX Clear (Futures)—the licensed clearing and settlement facility operated by ASX Clear (Futures) Pty Limited</li> <li>• ASX Settlement—the licensed clearing and settlement facility operated by ASX Settlement Pty Limited, and</li> <li>• Austraclear—the licensed clearing and settlement facility operated by Austraclear Limited</li> </ul>
ASX Limited	ASX Limited or the licensed securities exchange market operated by ASX Limited
ASX Trade	ASX's integrated equities and derivative trading platform
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
CP 196 (for example)	An ASIC consultation paper (in this example numbered 196)
ETF	Exchange traded fund—a type of investment fund that can be bought and sold on a securities exchange market and passively tracks an index

Term	Meaning in this document
ETP	Exchange traded product—the family name for the group of products comprising ETFs, managed funds and structured products  Note: Further information about ETPs can be found in <a href="#">REP 583</a> .
INFO 230 (for example)	An ASIC information sheet (in this example numbered 230)
issuer	A person who issues interests in an ETP to another person
KPI	Key performance indicator
KRI	Key risk indicator
LIC	Listed investment company, admitted under the ASX Listing Rules
LIT	Listed investment trust, admitted under the ASX Listing Rules
managed fund	A collective investment that is a registered scheme, the interests of which are admitted to quotation as securities of a managed fund by a market operator
managed investment scheme	Has the meaning given in s9 of the Corporations Act
market integrity rules	Rules made by ASIC, under s789G of the Corporations Act, for trading on domestic licensed markets
market licensee	A market operator licensed to operate a market in Australia under Pt 7.2 of the Corporations Act
market maker	A person who has entered into an agreement with the issuer to make a market for an ETP by providing two-way pricing spreads within specified limits
mFund	An unlisted managed fund; units in an mFund can be bought and sold via ASX's mFund settlement service
operating rules	The business rules and guidelines for the relevant market
RAS	Risk appetite statement
REP 583 (for example)	An ASIC report (in this example numbered 583)
RG 172 (for example)	An ASIC regulatory guide (in this example numbered 172)
s792A (for example)	A section of the Corporations Act (in this example, numbered 792A), unless otherwise specified

## Related information

### Headnotes

AQUA market, ASX, Corporations Act, equity market products, ETF, ETP, exchange traded fund, exchange traded product, financial market, licence, licensed financial market, market licence obligations, market operator, securities

### Regulatory guides

[RG 172](#) *Financial markets: Domestic and overseas operators*

### Legislation

*Australian Securities and Investments Commission Act 2001*, s30

Corporations Act, Ch 7, Pt. 7.2, s792A, 792D, 794C

### Information sheets

[INFO 230](#) *Exchange traded products: Admission guidelines*

### Consultation papers and reports

[CP 196](#) *Periodic statements for quoted and listed managed investment products and relief for AQUA products*

[REP 282](#) *Regulation of exchange traded funds*

[REP 373](#) *Response to submissions on CP 196: Periodic statements for quoted and listed managed investment products and relief for AQUA products*

[REP 480](#) *Assessment of ASX Limited's listing standards for equities*

[REP 583](#) *Review of exchange traded products*

[REP 592](#) *Review of ASX Group's technology governance and operational risk management standards*

### Media releases

[17-453MR](#) *Exchange traded products: Guidelines for market licensees*

[19-195MR](#) *ASIC implements pause on admission of managed funds with internal market makers*