



ASIC

Australian Securities & Investments Commission

REPORT 73

Market assessment report: EBS Service Company Limited

May 2006



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Annual assessment (s794C) report

EBS Service Company Limited
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Contents

Contents.....	2
Executive summary	3
Compliance by EBS.....	3
Section 1: Background.....	4
1.1 EBS and the market	4
1.2 The assessment process.....	4
Section 2: Observations.....	6
2.1 Conclusions.....	6
2.2 Supervisory arrangements – s792A(c)	6
2.3 Other obligations	9
Section 3: Recommendations	10

Executive summary

On 14 March 2005, EBS Service Company Limited (EBS) was granted a licence to operate the market known as EBS Spot. EBS was granted a licence under section 795B(1) of Corporations Act 2001 (the Act) as EBS Spot is not regulated as a market in a foreign jurisdiction. EBS is a Swiss incorporated subsidiary of EBS Group Limited.

This report summaries Australian Securities & Investments Commission's (ASIC) assessment under section 794C of EBS's compliance with its obligation to supervise the market under section 792A(c) of the Act. Section 2 of the report outlines ASIC's conclusions and sets out ASIC's observations of EBS's supervision and reporting requirements. Section 3 outlines ASIC's recommendations.

Compliance by EBS

ASIC is satisfied that EBS has and will continue to comply with its obligations under the Corporations Act.

Section 1: Background

1.1 EBS and the market

EBS is a Swiss incorporated subsidiary of EBS Group Limited. The ultimate shareholders of EBS Group Limited are ABN AMRO Bank, Bank of America, Barclays Bank, Citibank, Commerzbank, Credit Suisse First Boston, HSBC, JP Morgan, Lehman Brothers, The Royal Bank of Scotland, UBS Warburg AG, Skandinaviska Enskilda and Minex Corporation. These entities hold shares in EBS Group Limited through a number of wholly owned subsidiaries.

EBS Group Limited and its affiliates, including EBS, (together, the "EBS Group") are managed as a single group by a management committee ("Management Committee") made up of staff employed by affiliated companies EBS Dealing Resources, Inc. (EDRI) and EBS Dealing Resources International Limited (EDRIL). The staff are seconded to EBS Group Limited. As at 31 December 2005 EBS Spot had over 800 participants, with 27 being Australian participants.

EBS Spot is an electronic anonymous deal-matching trading system that facilitates trading by participants in spot foreign exchange and precious metals (that is, gold and silver). The trades are matched automatically by EBS Spot's IT system on a credit - price - time priority. Trades occur on an anonymous basis with the identity of the counterparty unknown to the participants before the trade is executed. However the system will only match trades between participants who have established mutual credit limits with each other.

Currently EBS Spot transacts on average daily volumes of foreign exchange of USD 120 billion, 500,000 ounces of gold and 4 million ounces of silver.

1.2 The assessment process

Section 794C(2) of the Act requires ASIC to assess whether EBS complies with its obligations in s792A(c) of the Act. In addition, s794C(1) permits ASIC to extend the scope of its annual report to assess how well EBS complies with any or all of its obligations under Chapter 7 of the Act.

In conducting our assessment, we took into account the matters set out in ASIC Policy Statement 172 'Australian market licences: Australian operators'. PS 172 explains how ASIC will assess how well a market licensee is complying with its obligations.

This is ASIC's first s794C assessment of EBS. In this assessment we reviewed the adequacy of EBS's supervision arrangements. In conducting our assessment under s794C, we:

- analysed information we received from and about EBS in the ordinary course of our dealings with the licensee;
- reviewed EBS's annual regulatory report under s792F;
- reviewed EBS's half yearly report required by the conditions of its Australian market licence (AML); and
- also considered how well EBS might comply with its obligations in the future.

We have discussed the results of our assessment with EBS, seeking their comments on both the factual matters set out in this report and our conclusions.

Section 2: Observations

2.1 Conclusions

After making our assessment, ASIC concludes that EBS has adequate arrangements for the supervision of its market in accordance with its obligations under section 792A(c) of the Act.

This conclusion is based on the following observations drawn from information gathered during the assessment process:

- EBS has not substantially changed the arrangements it has in place for supervising EBS Spot from the description provided in its Australian market licence application;
- no serious market failures or disruptions have come to our attention; and
- during our assessment, nothing came to our attention to suggest that the supervisory arrangements were not operating properly.

2.2 Supervisory arrangements – s792A(c)

Section 792A(c) of the Act requires a market licensee to have adequate arrangements for supervising the market including arrangements for:

- handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market is fair, orderly and transparent;
- monitoring the conduct of participants on or in relation to the market; and
- enforcing compliance with the market's operating rules.

Conflicts of interest

ASIC believes, in light of the nature of the market operated by EBS and the participants of that market, EBS's arrangements for handling conflicts are adequate. In forming this view we noted that EBS has demonstrated its awareness that there may be conflicts of interest between its commercial interests and its supervisory duties, and the market is restricted to participants who, it is reasonable to assume, understand the risks involved in the market and have the resources to adequately represent and protect their own interests.

EBS has informed us that there have been no significant conflicts of interest events during the assessment period. We note that, due to the structure of EBS's market, there are limited opportunities for conflicts of interest events to occur.

We note EBS's policies and procedures concerning conflicts of interest outlined in its annual regulatory report are similar to those that were described by EBS in its Australian market application. EBS has the following arrangements to handle conflicts of interest between its commercial interests and supervisory duties:

- (a) operating rules and written procedures have been put in place that set out clear outlines by which participants and EBS as a market licensee must operate;
- (b) EBS Group has an internal Code of Conduct which specifically deals with issues arising from actual or potential conflicts of interest. Each employee must sign the Code of Conduct each year to confirm that they understand and agree to comply with the Code of Conduct;
- (c) EBS uses objective criteria to determine whether an entity should be admitted as a participant of the market;
- (d) potential participants are notified that the shareholders of the EBS (excluding Minex) may be participants on the market;
- (e) the internal EBS Group protocol requiring the General Counsel to regularly attend meetings of the Management Committee. EBS believes that the attendance of General Counsel at these meetings allows the General Counsel to identify conflicts of interest between the EBS Group's commercial and supervisory obligations;
- (f) structural separation of commercial and supervisory activities within the EBS Group; and
- (g) any decision in relation to disciplinary action would be made by the Management Committee in discussion with EBS. In these circumstances it is important to note that the Management Committee is comprised of members who do not represent the shareholders.

Monitoring the conduct of participants

In ASIC's view, EBS has supervision arrangements which are adequate for EBS Spot, given the sophisticated nature of participants and the nature of the market.

In its annual regulatory report EBS submits its supervisory arrangements for monitoring the conduct of participants on and in relation to EBS Spot are adequate when the nature of EBS Spot and participants on the market are taken into account.

EBS outlines the nature of its market and participants in the following way:

- (a) users of EBS Spot are highly sophisticated entities with a detailed understanding of the market and financial products in which they deal;
- (b) EBS Spot's participants have already decided with whom they are willing to trade and have satisfied themselves as to the creditworthiness of those entities, although the identity of the counterparty is only revealed after the deal has been entered into; and
- (c) EBS Spot is a fully automated deal matching system.

Where possible EBS has incorporated operating rules into EBS Spot's IT system, making it difficult for participants to breach these operating rules. In its operating rules EBS requires participants to self-monitor their compliance with EBS Spot's operating rules. The operating rules require EBS Spot participants to appoint an employee in the role of Trading Floor Administrator. The Trading Floor Administrator is then responsible for the participant's smooth operation of the EBS Spot system.

The operating rules of EBS Spot require participants to notify EBS Customer Support if a participant suspects a problem with EBS Spot which may affect his/her use of the market. In such a case the participant must remove all their quotes from EBS Spot. The operating rules also require the participant to notify EBS Customer Support of any dispute with other participants. Participants are able to contact EBS Customer Support 24 hours a day 7 days a week. EBS Customer Support is able to determine the status of a disputed match or contract as recorded on the system.

Under the operating rules EBS has the right to access a participant's trading floor for the purpose of confirming that the participant is complying with the operating rules. EBS notes in its annual regulatory that it did not exercise its right to access the trading floor of any participant.

Enforcing compliance with operating rules

In ASIC's view, EBS has adequate arrangements for enforcing compliance with EBS Spot's operating rules. In forming this conclusion we noted the nature of the market and the participants on the market.

EBS has not substantially changed the processes, as outlined in its application for an Australian market licence, it has for enforcing compliance with its operating rules. EBS' arrangements for enforcing compliance with its operating rules includes:

- (a) if a participant has breached or is in the process of breaching the EBS Customer Agreement or is not complying with the EBS Spot Dealing Rules, EBS may withdraw a participant's access to, or suspend EBS' provision of EBS Spot;

- (b) EBS has the power to request that a participant terminate an employee's access to EBS Spot if the employee is in breach of the EBS Spot Dealing Rules;
- (c) EBS has the power to remove any bid or offer from EBS Spot if the bid or offer breaches or contains material prohibited by the EBS Spot Dealing Rules, or if it is impairing or reducing the efficiency of the system; and
- (d) under the operating rules each participant agrees that its obligations to comply with operating rules are legally enforceable against it by each other participant (as well as by EBS).

EBS states in its annual regulatory report that it has not needed to exercise any of the above rights throughout 2005.

2.3 Other obligations

Reporting obligations

Annual regulatory report

EBS lodged its section 792F annual regulatory report for the period 14 March 2005 to 31 December 2005 with ASIC on 30 January 2006. ASIC notes that this report was lodged within the required period for lodgement and that the reports contained the information required.

Reports required by licence

Under section 8 of its market licence, EBS must lodge reports with ASIC every six months that provide information about the volumes traded on EBS in Australia and globally, and list all Australian participants. ASIC notes that the section 8 report was lodged within the required period, and that the reports contained the information as required under the licence.

Section 3: Recommendations

Based on this assessment, ASIC does not have any recommendations to make in relation to EBS's current supervisory arrangements.