



ASIC

Australian Securities & Investments Commission

REPORT 354

Market assessment report: London Metal Exchange

ARBN 120 748 021

July 2013

About this report

This assessment covers the period 11 April 2012 to 9 April 2013 (the assessment period).

About ASIC regulatory documents

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

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

Regulatory guides: give guidance to regulated entities by:

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

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

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

Previous reports on London Metal Exchange (LME)

LME was granted an Australian market licence for an overseas market on 10 April 2007.

Report number	Report date
REP 305	October 2012
REP 250	August 2011
REP 209	June 2010
REP 170	August 2009
REP 147	December 2008

The assessment

Key points

ASIC is satisfied that LME has adequate arrangements for operating its market in accordance with its obligations under s792A(c) of the *Corporations Act 2001* (Corporations Act). We do not have any recommendations to make about these arrangements.

Scope

- 1 Under s792A(c)¹ a market licensee is required to have adequate arrangements for operating its market, including arrangements for:
 - handling conflicts between its commercial interests and the need to ensure that the market is fair, orderly and transparent; and
 - monitoring and enforcing compliance with the market's operating rules.
- 2 ASIC is required to assess how well a market licensee complies with its obligations under s792A(c) at least once a year: s794C(2). ASIC is permitted to extend the scope of its assessment to review how well a licensee complies with any or all of its obligations under Ch 7.

Approach to assessment

- 3 LME is one of a small number of financial markets that are licensed to operate in Australia under the foreign licensing arrangements in the Corporations Act: s795B(2).
- 4 Under the arrangements in s795B(2), a foreign financial market may be permitted to operate in this country if the operation of the market in its home jurisdiction is subject to requirements and supervision that are sufficiently equivalent to those that apply to financial markets in Australia.
- 5 In assessing whether a market's home jurisdiction satisfies this requirement, we focus on whether that jurisdiction achieves sufficiently equivalent investor protection and market integrity outcomes to those achieved for comparable domestic markets.

¹ In this report, references to legislation (e.g. s792A(c), Ch 7, Pt 5B.2) are references to the Corporations Act, unless otherwise specified.

6 In addition, as a condition of LME's market licence, Australian-based clients of participants of LME's market must be first notified that LME is regulated primarily under the regulatory regime of the United Kingdom.

7 ASIC's current strategic framework focuses on three key priorities or outcomes. These are:

- confident and informed investors and financial consumers;
- fair and efficient financial markets; and
- efficient registration and licensing.

The first two priorities are particularly important for licensed markets.

8 In the context of foreign licensed markets, the importance placed on the regulatory arrangements in the operator's home jurisdiction means that in assessing whether our strategic priorities are being met, our primary focus is on the extent to which LME continues to satisfy the regulatory requirements of that home regime. We also consider whether there have been any significant changes to that regulatory regime.

9 For that reason, our assessment of these types of markets focuses on a narrower subset of the key measures than we might otherwise use if the market was a comparable domestic licensed market. To determine whether LME has complied with its obligations to have adequate arrangements for operating its market, we focused on:

- information provided by the LME's home regulator about:
 - the standing of LME;
 - any disciplinary action taken against LME; and
 - any reviews or on-site risk assessments of LME;
- information provided by LME about whether:
 - there have been any significant changes to the regulatory regime in the home jurisdiction (as required by s792B(4)(b));
 - there have been any complaints by market participants to LME about the operation of the market;
 - LME has taken any disciplinary action against Australian participants; and
 - LME's arrangements for operating the market changed; and
- whether ASIC has received any complaints about the operation of the market.

Background

- 10 On 6 December 2012, Hong Kong Exchanges and Clearing Limited (HKEx) completed the acquisition of the entire issued ordinary share capital of LME Holdings Limited, the parent company of LME.
- 11 LME is a leading exchange for the trading of non-ferrous metals. LME offers a range of futures and options contracts over non-ferrous and minor metals and steel. Trading on LME takes place across three platforms: by open outcry, the inter-office telephone system and through LMEselect, LME's electronic trading platform.
- 12 Transactions effected through LME's market are cleared and settled by LCH.Clearnet Limited.
- 13 LME's compliance department is planning to implement a new monitoring system. This new system is designed to improve LME's ability to monitor trading in real-time on its market by enabling the creation of bespoke alerts that will flag certain activities immediately upon occurrence.
- 14 LME's annual trading volume for 2012 was 159.7 million contracts, this is an increase of 8.9% when compared with 2011 (146.6 million).

Regulation of LME in Australia

- 15 LME was registered under Div 2 of Pt 5B.2 as a foreign company in Australia on 9 August 2006.
- 16 LME was granted an Australian market licence to operate LMEselect on 10 April 2007, under the foreign licensing arrangements in the Corporations Act. A copy of LME's market licence is available on the ASIC website at www.asic.gov.au/markets.
- 17 LME requires all Australian participants to hold (or be exempt from holding) an Australian financial services (AFS) licence, permitting them to trade in the products that can be dealt with on LME's market.

Regulation of LME in the United Kingdom and other jurisdictions

- 18 On 1 April 2013, a new system for regulating financial services in the United Kingdom (UK) came into effect. The Financial Services Authority (FSA) which was previously the sole body responsible for financial services regulation in the UK was replaced by two new regulators—the Financial Conduct Authority (FCA) and the Prudential Regulation Authority (PRA). The FCA has three statutory objectives:
- to protect customers;

- to enhance the integrity of the UK financial system; and
 - to help maintain competitive markets and promote effective competition in the interests of consumers.
- 19 The PRA is responsible for the prudential regulation and supervision of banks, building societies, credit unions, insurers, and major investment firms. One of its objectives is to promote the safety and soundness of the firms that it regulates. The PRA is part of the Bank of England.
- 20 During the majority of the assessment period, LME was supervised and regulated in the UK by the FSA as a Recognised Investment Exchange (RIE) under the *Financial Services and Markets Act 2000* (UK). LME continues to be an RIE, but from 1 April 2013 it is supervised and regulated by the FCA. As an RIE, LME has regulatory responsibility in its own right. It is required to maintain sufficient financial resources, adequate systems and controls, and effective arrangements for monitoring and disciplining its members.
- 21 The FCA confirmed that HKEx's acquisition of LME does not have an impact on LME's arrangements for supervising its market, arrangements for monitoring the conduct of participants, and LME's ability to enforce compliance with its operating rules.
- 22 LME is also authorised, permitted, or has confirmed that no authorisation or permission is required, to offer its electronic trading system in a number of other jurisdictions, including the United States, China, Hong Kong, Japan and Singapore.

Our assessment process

- 23 We use the assessment process to reach conclusions about the adequacy of the arrangements a market licensee had in place for operating its market in accordance with its obligations, and to identify issues that in our view need (or may need) to be addressed to ensure ongoing compliance.
- 24 In conducting our assessment we considered:
- information from the FCA about LME;
 - information we received from and about LME in the ordinary course of our dealings with LME, including information sought from LME for the purpose of this assessment;
 - LME's:
 - annual regulatory report required under s792F;
 - six-monthly licence conditions report; and
 - financial report for the year ended 31 December 2012; and

- information from the media, LME's website and other sources.
- 25 LME has had the opportunity to view and comment on the factual accuracy of a draft version of this report. Where appropriate, our findings reflect LME's clarifications.

Our observations

Arrangements for operating the market

- 26 We conclude that during the assessment period LME had adequate arrangements for the operation of its market in accordance with its obligations under s792A(c).
- 27 Our conclusion is based on our review of the measures that typically guide our assessment of LME and like markets, being:
- the FCA confirmed that LME continues to be recognised as an RIE. The FCA also confirmed that there was no disciplinary action taken against LME over the course of the past year;
 - during the assessment period, LME did not notify us of any significant changes to the regulatory regime in its home jurisdiction, however, during the assessment period the responsibility for the supervisory and regulatory oversight of LME as an RIE was transferred to the FCA (see paragraph 20);
 - LME confirmed that during the assessment period:
 - there was one complaint made by a market user which related to a delay in delivery of metal from a warehouse, the complaint was resolved;
 - LME did not take any disciplinary action against any Australian participants; and
 - LME's arrangements for operating the market did not change; and
 - during the assessment period, we did not receive any complaints about the operation of the market.

Reporting obligations

- 28 We note that LME lodged its annual regulatory report (as required under s792F) with ASIC in a timely manner with the required information.
- 29 We also note that LME lodged its six-monthly reports with us on time and these contained the information required.
- 30 LME has provided notices on rule changes in a timely manner and with sufficient information to satisfy s793D(3).