



**ASIC**

Australian Securities & Investments Commission

**REPORT 64**

# **Market assessment report: Reuters Transaction Services Limited**

November 2005



**ASIC**

Australian Securities & Investments Commission

## **Annual assessment (s794C) report**

**Reuters Transaction Services Limited**  
**ARBN 108 137 766**

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# Executive summary

This report is an assessment of compliance by Reuters Transaction Services Limited (RTSL) with its obligations under s792A(c) of the *Corporations Act 2001* (the Act). RTSL is licensed to operate the financial market currently known as Reuters Treasury Broking Service in Australia. RTSL is regulated in this jurisdiction by ASIC under Part 7.2 of the *Corporations Act 2001*. However, the principal places of business of RTSL is located in the United Kingdom and the market is regulated primarily under the regulatory regime of the United Kingdom.

Section 794C of the Act requires ASIC to assess how well a licensed market operator is complying with its obligations as the holder of a market licence and, in particular, whether a market operator has adequate arrangements for supervising the market it operates. This is our first assessment of RTSL since it was licenced in July 2004.

## Compliance by RTSL with statutory obligations

As a result of our assessment of RTSL, ASIC is satisfied that RTSL has and continues to have adequate arrangements for supervising its market. This assessment is based on the supervisory arrangements as described in section 2.1 of this report and takes into account the nature of the market and its participants.

## Observations and recommendations

ASIC is satisfied that RTSL has and continues to have adequate arrangements for supervising its market. We have not made any recommendations in this report about changes to RTSL's supervisory arrangements.

# Section 1: Background

## 1.1 RTSL and the market

RTSL was granted an Australian market licence on 28 July 2004. The licence permits RTSL to operate its market, known as Reuters Treasury Broking Service (RTBS), in this jurisdiction. ASIC is responsible for regulating the market in this jurisdiction under Part 7.2 of the Act.

The classes of financial product that can be dealt with on RTBS are:

- (A) foreign exchange contracts; and
- (B) derivatives that:
  - (i) are foreign exchange or interest rate derivatives; and
  - (ii) are entered into under the current International Swaps and Derivatives Association, Inc. Master Agreement or another commonly used master agreement for foreign exchange or interest rate derivatives.

The market is an electronic multilateral trading platform designed to trade sophisticated financial products .

The market is provided over the Reuters Transactions Network, a private dedicated global network maintained by the Reuters Group. All network connectivity and hardware is supplied and supported by the Reuters Group.

Participation is restricted to banks trading on their own behalf. There are approximately 1144 participants globally in spot and forwards products, 36 of which are Australian (including the Reserve Bank of Australia), and there are approximately 49 worldwide participants in options, 3 of which are Australian.

### *Dealing Spot Matching*

This system provides an anonymous electronic broking service for spot foreign exchange trading. The spot matching system provides access between participants to real-time executable prices from a wide range of currency pairs. The spot matching system attempts to match each incoming order against existing orders on the system based on best price, time and quantity available, subject to mutual credit existing between the counterparties. Both counterparties then receive match notifications, the deal is affected and the system automatically draws down on each counterparty's respective credit limits.

*Reuters Dealing Forwards Matching*

This system provides an anonymous electronic broking service for the forward foreign exchange swap market and is currently available in 33 countries, trading 22 forwards instruments with trading periods ranging from overnight to one year. The forwards matching system evaluates each order based on price and quantity, subject to a mutual credit indication between the counterparties. When the system identifies a potential match, it notifies the counterparties by sending them a proposal that reveals the identity of the counterparties to enable them to review their credit limits outside the system and agree the quantity of the proposed deal.

*Interest rate swaps system*

This system permits participants to list prices on the system and for other participants to agree to transact at those listed prices. The system reveals the identity of each counterparty to the proposed trade so that they may conduct credit checks. The system also supports a 'pre clearing' of credit, meaning that trades between pre-cleared participants have automatic deal confirmation without the need for a credit check.

*Foreign Exchange Options trading system*

This system provides a platform where market participants are able to anonymously post bids and offers for specific transaction structures and then negotiate those transactions electronically including credit approval and post trade details.

Participants control all postings, negotiation and agreement of transactions on all of the systems. Once a potential trade has been identified and both parties accept credit, then the trade progresses into the 'negotiation of details' phase where post trade details must be agreed. Post trade details that can be negotiated depend on the structure of the product, but often pertain to the spot, swap and deposit rates, and the size of the deal, fixed terms include the expiry, delivery, strike or delta, volatility and type. Negotiation occurs via the system, back and forth until all negotiable variables are agreed.

Payment and settlement of deals is the responsibility of the relevant counterparties. Participants control their own credit risk exposure through setting specific credit limits and participants are also responsible for settling trades with their trade counterparties.

RTSL only permits banks, investment banks and their subsidiaries to participate in the market in Australia. Each participant trades on its own behalf, or on behalf of related bodies corporate.

*Regulation of RTSL in United Kingdom*

RTSL is authorised and regulated in the United Kingdom by the Financial Services Authority (FSA) to operate the RTBS Services. RTSL has also been approved as a money broker by both the Hong Kong Monetary Authority and by the Monetary Authority of Singapore.

RTSL is authorised by the FSA to operate its market in accordance with Part IV of the Financial Services and Markets Act 2000. A Part IV permission is granted by the FSA to allow a person to carry on one or more 'regulated activities'. The FSA regulates RTSL under the Alternative Trading System (ATS) regime as set out in the FSA Handbook of rules and guidance. A number of conditions are attached to RTSL's Part IV permission.

*Regulation of RTSL in Australia*

RTSL's Australian market licence was granted under s795B(2) of the Act, which lists criteria for granting a market licence to an overseas-based operator. These criteria include a requirement that the regulatory regime of the home country is sufficiently equivalent in terms of investor protection and market integrity outcomes to the Australian regulatory regime. Consequently, our approach to regulating overseas-based markets places a degree of reliance on the regulatory regime imposed by the home regulator of that market.

While RTSL is required to comply with each of its obligations under the Act and any conditions imposed on its licence, ASIC necessarily relies to some extent on the regulation of RTSL undertaken by the FSA to be satisfied that RTSL is complying with its Australian obligations.

In this regard we note that ASIC and the FSA are signatories to two memoranda of understanding concerning consultation, cooperation and exchange of information.

**1.2 The assessment process**

ASIC undertakes an annual assessment under s794C(2) of the Act to determine whether a licensee complies with its obligations in s792A(c) of the Act relating to supervision of the market.

Section 794C(1) permits ASIC to extend the scope of its annual report to assess how well a licensee complies with any or all of its obligations under Chapter 7 of the Act. We have extended the scope of this report to include a number of matters of compliance noted during the assessment period.

### **How we conducted this assessment**

Our assessment of RTSL was based on information that ASIC had at hand, and information obtained from RTSL and from the FSA.

Specifically, in conducting our assessment under s794C, we:

- analysed information received from and about RTSL in the ordinary course of our dealings with RTSL;
- reviewed RTSL's most recent annual report, RTSL 's annual regulatory report under s792F, and a six-monthly market report provided in accordance with section 9 of RTSL's market licence;
- sought additional information from RTSL for the purpose of this assessment;
- obtained information from the FSA about the market and RTSL; and
- considered how well RTSL might comply with its obligations in the future.



## Section 2: Observations and Recommendations

After making our assessment, ASIC concludes that RTSL has and will continue to comply with its obligations under s792A(c) of the Act. Section 2.1 addresses our obligation under s794C(2) to assess the adequacy of RTSL supervisory arrangements. Section 2.2 discusses other areas of compliance that were noted during the assessment period.

### 2.1 Supervision of the market

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

1. In its application for an Australian market licence, RTSL described a number of arrangements for supervising its market. These arrangements were assessed as being adequate to satisfy the requirement under s792A at the time of, and as evidenced by, the granting of RTSL's market licence.
2. RTSL confirmed to ASIC that the arrangements for supervising the market had not changed in any material way from the description provided in its application for a market licence.
3. FSA confirmed that it had no concerns with RTSL's supervision of its market.
4. During our assessment, nothing came to our attention to suggest that the supervisory arrangements were not operating properly.

No issues involving Australian participants came to our attention during the assessment period. RTSL has not notified ASIC of any disciplinary actions involving Australian participants.

#### Handling conflicts of interests

Paragraph 792A(c)(i) of the Act requires that RTSL must have adequate arrangements for handling conflicts between its commercial interests and the need for it to ensure that the market operates in a fair, orderly and transparent way.

RTSL submits that due to the nature of the facility it provides, the potential for conflict between commercial interest and supervisory obligations is limited. RTSL does have some arrangements in place to manage such conflicts, as follows:

- (a) where a trading issue involves, or is suspected to involve some form of, market abuse or some other financial crime, the issue is

passed directly to the Head of Regulation and Compliance at RTSL;

- (b) the Reuters Code of Conduct applies to all Reuters Group employees, including all those Reuters employees who are undertaking work for or on behalf of RTSL . It states that it is Reuters' practice to promote and sell Reuters products in a fair and even- handed manner, and that confidential information must not be misused. Breaches of the Code of Conduct can lead to dismissal; and
- (c) contractually, RTSL effectively commits to offering and operating a fair, orderly and transparent market primarily through the RTSL contract and the operating rulebooks, which establish a level playing field for all participants. The system itself is likely to provide for a fair,ordely and transparent market through:
- the trading methodology – for example, the spot automated matching methodology is based on the best price, time and quantity available, subject to mutual credit existing between the counterparties;
  - providing participants with market information- for instance, both the market price and the best price at which a participant can trade subject to credit limits are displayed to participants;
  - Reuter's code of conduct, which requires that all RTSL customers be treated in an equitable way; and
  - RTSL is obliged to keep all participant details confidential except in those circumstances where asked to provide details by a regulator or other law enforcement agency.

### **Monitoring the conduct of participants**

Paragraph 792A(c)(ii) of the Act requires that RTSL must have adequate arrangements for monitoring the conduct of participants on or in relation to the market.

In accordance with all relevant anti-money laundering legislation and market supervisor requirements, RTSL is under a legal obligation to report suspicious activity to the UK National Criminal Intelligence Service or the FSA as appropriate.

RTSL also has documented procedures for ongoing monitoring of participants. These procedures include a monthly monitoring check of at least 10 participants, with the subsequent preparation of a report to the Head of Regulation and Compliance. The report details:

- a list of new participants;
- participants reviewed that month and any problems that may have arisen;
- material published by regulators and other bodies about participants or countries that might require RTSL to focus its monitoring on a specific area/ client group; and
- whether a participant is undertaking the anticipated volume of activity on the system (by checking the participant's business profile or credit assessment vetting form).

Any trade monitoring that is undertaken by RTSL is the primary responsibility of the administration team based in Geneva, which reports to the Head of Regulation and Compliance. Monitoring carried out through reviews of a participant's business profile and trading activity, to determine whether the participant is trading as anticipated.

Additionally, a client may report a potential problem to RTSL, who will then investigate the situation as quickly as possible and take action as necessary. Again, all such problems that may arise would be escalated to the Head of Regulation and Compliance. In conjunction with the administration team based in Geneva an investigation of the matter would take place.

The agreement entered into between RTSL and its participants confers on RTSL a right of access to any participant's premises at any time on a reasonable basis to undertake inspections of equipment and books relating to the use of the system.

It is also noted that RTSL keeps records of each transaction for five years from the date of completion of a transaction.

### **Enforcing compliance with the market's operating rules**

Paragraph 792A( c)(iii) of the Corporations act requires that RTSL have adequate arrangements for enforcing compliance with the market's operating rules.

In the event that a participant breaches the RTSL operating rules, which for the purposes of the Corporations Act include the various market rulebooks and the user agreements, the matter is brought to the attention of the Head of Regulation and Compliance. If the breach is not rectified, or RTSL perceives the breach to be deliberate in the first instance, then the participant agreement allows for RTSL to:

- (a) suspend or terminate the agreement thereby suspending or terminating access to the system; and/or
- (b) report that client to the local regulatory authority; and/or
- (c) report that client to a law enforcement authority.

No issues involving Australian participants came to our attention during the assessment period. RTSL has not notified ASIC of any disciplinary actions involving Australian participants.

## **2.2 Other observations**

### **Obligations to notify ASIC**

RTSL has a number of ongoing obligations under the Act and its license conditions, including the following:

- lodgement of an annual regulatory report with ASIC pursuant to section 792F of the Act;
- lodgement of a report with ASIC pursuant to section 9 of its market every 6 months that provides information about volumes traded on RTSL in Australia and globally, and lists all Australian participants; and
- written notification to ASIC pursuant to subsection 793D(3) of the Act if a change is made to the operating rules of the market, as soon as practicable after the change is made.

ASIC is satisfied that RTSL has met these obligations.