



**ASIC**

Australian Securities & Investments Commission

**REPORT 92**

# **Market assessment report: Board of Trade of the City of Chicago Inc**

February 2007



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Australian Securities & Investments Commission

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

**Board of Trade of the City of Chicago Inc.  
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# Executive summary

This report summarises ASIC's first assessment under section 794C of the *Corporations Act 2001* (Act) of compliance by Board of Trade of the City of Chicago Inc (CBOT) with its obligations under section 792A(c) of the Act. We also assessed CBOT's compliance with some of its reporting obligations under the Act. This report describes our assessment, conclusions and recommendations.

## Compliance by CBOT

We conclude that CBOT has adequate arrangements for supervising its market, including arrangements for:

- handling conflicts between its commercial interests and the need to ensure that the market operates in a fair, orderly and transparent manner;
- monitoring the conduct of participants in the market; and
- enforcing compliance with its operating rules.

## Our approach

ASIC uses the formal assessment process to examine whether a market licensee has been and is continuing to meet its supervisory obligations. We also use the process to identify areas where improvements may be needed to enable the licensee to meet its obligations in the future.

# Section 1: Background

## 1.1 CBOT and the market

CBOT was granted an Australian market licence on 7 December 2005. The licence permits CBOT to operate its market in this jurisdiction. ASIC is responsible for regulating the market in this jurisdiction under Part 7.2 of the Act.

CBOT was established in 1848. It is registered as a "designated contract market" and a "derivatives clearing organisation" by the Commodity Futures Trading Commission (CFTC) in the United States. This permits CBOT to operate a futures and options trading facility and a clearing organisation respectively in the US.

CBOT operates both a floor trading market (open outcry) and an electronic trading platform, which was introduced in 1992. On 12 October 2005 the CBOT relaunched an enhanced trading platform called e-cbot.

CBOT requires all Australian participants to hold an Australian financial services licence that permits them to trade in products of the same kind as those that can be dealt with on the market unless the participant is exempt under Australian law from the requirement to hold such a licence in relation to participation in the market.

On the 17 October, 2006 Chicago Mercantile Exchange Inc (CME) and the Chicago Board of Trade (CBOT) announced a merger of the two companies. Subject to regulatory and shareholder approval, the merger transaction is scheduled to close in the second quarter of 2007.

### *Regulation of CBOT in the USA*

CBOT is currently authorised to operate its market through its registration with the CFTC. CBOT is a self-regulating body with its own by-laws, rules and regulations which are contained in the CBOT Rulebook. Its role as front-line supervisor is overseen by the CFTC, which administers the legislation and related regulations. The purpose of that regulatory regime is to serve the public interest by protecting investors, ensure market integrity and to avoid systemic risk.

### *Regulation of CBOT in Australia*

CBOT'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 CBOT is required to comply with each of its obligations under the Act and any conditions imposed by its licence, ASIC continues to rely to some extent on the regulation of CBOT undertaken by the CFTC to be satisfied that CBOT is complying

with its Australian obligations. ASIC and the CFTC continue to be party to two memoranda of understanding concerning consultation, cooperation and exchange of information.

## **1.2 The assessment process**

### **ASIC's role**

Section 794C of the Act requires ASIC to assess how well a licensee is complying with its obligations under s792A(c) of the Act to supervise its market. The assessment must consider whether the licensee has 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 it operates is a fair, orderly and transparent market.

Section 794C(1) of the Act permits ASIC to extend the scope of its annual assessment to the licensee's compliance with any or all of its obligations under Chapter 7 of the Act. We have extended the scope of our assessment to consider CBOT's compliance with some of its reporting obligations under the Act.

### **Assessment process**

Our assessment of CBOT was based on information that ASIC had at hand, and information obtained from CBOT and from the CFTC. Specifically, in conducting our assessment under s794C, we:

- analysed information received from and about CBOT in the ordinary course of our dealings with CBOT;
- sought additional information from CBOT and the CFTC for the purpose of this assessment; and
- considered how well CBOT might comply with its obligations in the future.

## Section 2: Observations

### 2.1 CBOT is meeting its obligations under section 792A(c)

After making our assessment, ASIC concludes that CBOT has adequate arrangements for the supervision of its market in accordance with its obligations under section 792A(c) of the Act based on the following observations drawn from information gathered during the assessment process:

1. CBOT confirmed to ASIC that its arrangements for supervising the market have not changed in any material way from the description provided in the previous annual reporting period;
2. CFTC has indicated that it presently has no information which would cause it to suspect or conclude that the CBOT has not been meeting its supervisory obligations in operating its market; and
3. During our assessment, nothing came to our attention to suggest that the supervisory arrangements were not operating properly.

### 2.2 Other observations

#### Regulation of CBOT in the United States of America

CBOT's authorisations and permissions to operate its market have not changed. CBOT remains designated as a contract market under the Commodity Exchange Act and continues to meet its self-regulatory obligations.

The CFTC conducted routine surveillance of market activities and a rule enforcement review of CBOT's audit trail, trade practice surveillance, disciplinary and dispute resolution programs during the assessment period, and also recently commenced an additional rule enforcement review of CBOT's market surveillance program. The CFTC has not identified any inadequacies in CBOT's market monitoring programs, and is satisfied that CBOT maintains sophisticated electronic surveillance system and operates adequate regulatory programs to enforce its rules.

#### Reporting obligations

##### *Annual regulatory report*

CBOT lodged its s792F annual regulatory report with ASIC on 29 March 2006. ASIC notes that the report was provided in a timely manner and the content of the report met the regulatory requirements.

##### *Operating rule changes*

Section 793D(3) of the Act requires CBOT to provide ASIC with a written notice if a change is made to the rules of the market as soon as practicable after the change is made. ASIC acknowledges that CBOT has provided notices in relation to rule changes in a timely manner and with sufficient information to satisfy CBOT's obligation.

*Change in holding or voting power*

Pursuant to section 792B(5) of the Act, CBOT provided notice to ASIC of changes in senior office bearers at CBOT in a timely manner and with sufficient information to satisfy the regulatory requirements.



## **Section 3: Recommendations**

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