



ASIC

Australian Securities & Investments Commission

REPORT 72

Market assessment report: Chicago Mercantile Exchange Inc

May 2006



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Annual assessment (s794C) report

**Chicago Mercantile Exchange Inc.
ARBN 103 432 391**

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Executive summary

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

Compliance by CME

We conclude that CME 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.

CME has made substantial and satisfactory progress in addressing matters we raised in our last report.

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 CME and the market

CME was granted an Australian market licence on 23 December 2003. The licence permits CME to operate its market, Globex®, in this jurisdiction. Globex® is an electronic trading platform through which CME's futures and options on futures contracts are traded. CME has advised that it currently has one Australian participant connected to Globex®. ASIC is responsible for regulating the market in this jurisdiction under Part 7.2 of the Act.

Regulation of CME in the USA

CME continues to be authorised to operate its market through its registration with the CFTC. CME is a self-regulating body with its own by-laws, rules and regulations contained in the CME 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 CME in Australia

CME'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.

Accordingly ASIC continues to rely to some extent on the regulation of CME and CME's Globex® platform undertaken by the CFTC to be satisfied that CME 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 determine 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 CME's compliance with some of its reporting obligations under the Act.

Assessment process

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

Specifically, in conducting our assessment under s794C, we:

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

Section 2: Observations

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

After making our assessment, ASIC concludes that CME 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. CME 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 CME has not been meeting its supervisory obligations in operating Globex®; 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 CME in the United States of America

CME's authorisations and permissions to operate its market have not changed. CME 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 CME's audit trail, trade practice surveillance, disciplinary and dispute resolution programs during the assessment period. Although the rule enforcement review is ongoing, the CFTC has advised that, preliminarily, it has not identified any inadequacies in CME's market monitoring program, and is satisfied that CME maintains sophisticated electronic surveillance systems and regulatory programs to enforce its rules.

Reporting obligations

In our first assessment report of CME we noted some issues with CME's compliance with its reporting obligations. ASIC has seen considerable improvement in CME's compliance with its reporting obligations and acknowledges that CME provided the following reports and notices in an adequate and timely manner during this assessment period.

Reports required by licence

Section 10 of CME's market licence requires CME to lodge with ASIC a report each six months that provides information about the volumes traded on Globex® in Australia and globally, and lists all Australian participants.

ASIC acknowledges that CME provided its six monthly report in a timely manner and with sufficient information to satisfy CME's obligation. ASIC and CME have agreed on the future presentation and content of the information provided by CME in their reports for the benefit of both parties.

Operating rule changes

Section 793D(3) of the Act requires CME 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 CME has provided notices in relation to rule changes in a timely manner and with sufficient information to satisfy CME's obligation.

Change in holding or voting power

Pursuant to section 792B(5) of the Act, CME provided notice to ASIC of changes in senior office bearers at CME 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 CME's current supervisory arrangements.