



**ASIC**

Australian Securities & Investments Commission

**REPORT 147**

**Market assessment report:**

**The London Metal  
Exchange Limited**

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**About this report**

This report summarises ASIC's first annual assessment of The London Metal Exchange Limited (LME) under s794C of the *Corporations Act 2001* (Cth) (Corporations Act).

### 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.

### First report on LME

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

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## Key findings and recommendations

### Key findings

- 1 ASIC is satisfied that LME has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.

### Recommendations

- 2 ASIC does not have any recommendations to make about LME's current supervisory arrangements.

## A The assessment

### Key points

ASIC conducts annual assessments of market licensees, such as LME, because it is required to do so under s794C of the Corporations Act.

The scope of our assessment must always include the obligations in s792A(c) of the Corporations Act, but we can include other Chapter 7 obligations too.

ASIC uses the licensee's self-assessment reports, our observation of the licensee's performance, market intelligence and other things to form a view of how well the licensee has operated its market.

### Purpose and scope

- 3 We are required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year (s794C(2)).
- 4 A market licensee is required to have adequate arrangements for supervising the market (under s792A) including 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.
- 5 In addition, we are permitted to extend the scope of our assessment to review how well LME complies with any or all of its obligations under Chapter 7 of the Corporations Act: s794C(1).

### Background

- 6 LME is a wholly owned subsidiary of LME Holdings Limited, a private limited company registered in England and Wales.
- 7 It is the world's centre for trading non-ferrous metal and plastics derivative contracts. In 2007, LME achieved volumes of 93 million lots, equivalent to US\$9,500 billion annually and between US\$35-45 billion on an average business day. Australian participation accounts for less than 0.3% of the total traded volume in the market.

- 8 LME was granted an Australian market licence, for an overseas market operator on 10 April 2007. The market licence permits LME to operate its financial market, LME Select, in Australia. LME Select is an electronic trading system that facilitates trading in financial derivatives on a number of metals and plastics. Trading also takes place through open outcry and inter-office telephone systems.
- 9 The only organisations able to trade on LME Select are its member firms, of which there are five main categories that vary in their associated obligations and responsibilities. LME members provide the physical industry with access to the market, to the risk management tools and to the delivery mechanism.
- 10 The LCH.Clearnet Limited is LME's contracted central counterparty clearing house, where all LME contracts are cleared.

### **Regulation of LME in the United Kingdom**

- 11 LME is authorised and regulated in the UK by the Financial Services Authority (FSA) as a recognised investment exchange under the *Financial Services and Markets Act 2000* (UK).
- 12 LME is currently also authorised to operate in several other jurisdictions including the United States of America, Hong Kong and Singapore.

### **Regulation of LME in Australia**

- 13 In Australia, LME is registered as a foreign company under the Corporations Act and as an overseas-based operator, its market licence was granted under s795B(2) of the Corporations Act. The criteria under this section includes a requirement that the regulatory regime of the foreign country is sufficiently equivalent in terms of investor protection and market integrity outcomes to the Australian regulatory regime. Consequently, while LME is required to comply with each of its obligations under the Corporations Act and any conditions imposed on its licence, ASIC places a degree of reliance on the regulatory regime imposed by the FSA on LME.
- 14 LME requires all Australian participants to hold an Australian financial services (AFS) 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 an AFS licence to participate in the market.
- 15 A copy of LME's market licence is available on our website at [www.asic.gov.au](http://www.asic.gov.au).

## Our methodology

### Our assessment process

- 16 A market licensee's obligations are ongoing. Whether it is likely to comply with its obligations in the future cannot be judged merely by reference to its past compliance.
- 17 We therefore use the assessment process to:
- reach conclusions about the adequacy of the arrangements a market licensee has in place for supervising its market in accordance with its obligations under the Corporations Act at the time of the assessment; and
  - identify issues, which in our view need, or may need, to be addressed to ensure ongoing compliance.

### What we considered

- 18 In conducting our assessment of LME we:
- analysed information we received from and about LME in the ordinary course of our dealings with the licensee;
  - reviewed LME's annual regulatory report required under s792F;
  - reviewed information from the media, LME's website and other sources;
  - reviewed LME's 6-monthly reports to ASIC;
  - sought additional information from LME for the purpose of this assessment; and
  - obtained information from the FSA about LME.

### Discussions with the foreign regulator

- 19 In assessing an overseas licensee's compliance with its obligations under s792A(c) of the Corporations Act, we place significant reliance on statements by the licensee's home regulator in regard to the standing of the licensee. ASIC has received confirmation from the FSA that they are not aware of any information or instances indicating the inadequacy of LME's supervisory arrangements.

### Consultation

- 20 LME has had the opportunity to view and comment on the findings and recommendations contained in a draft version of this report. Where appropriate, this report reflects LME's responses.

## **What we focused on for this assessment**

- 21 Our focus in this assessment was to review how well LME complied with its ongoing supervisory and reporting obligations under its market licence and the Corporations Act.



## B Our observations

### Key points

As part of this assessment we have considered the adequacy of LME's arrangements and resources for supervising its market including:

- 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.

ASIC has also considered LME's compliance with its reporting obligations under the Corporations Act.

### Supervisory arrangements

- 22 We conclude that LME has adequate arrangements and resources for the supervision of its market in accordance with its obligations under s792A(c).
- 23 This conclusion is based on the following observations drawn from information gathered during our assessment process, our observations from our ongoing correspondence with LME, and the present operating conditions (including trading volumes and financial products traded on the market):
- LME confirmed the arrangements for supervising the market have not changed since LME submitted their application for a market licence.
  - The FSA confirmed that it had no information indicating the inadequacy of LME's arrangements for supervising the market.
  - During our assessment, nothing came to our attention to suggest that the supervisory arrangements were not operating properly.

### Conflicts of interest

- 24 The FSA requires LME to manage conflicts of interest fairly, both between itself and its customers and between a customer and another client.
- 25 Where an actual or potential conflict of interest arises in relation to a decision to be taken by the LME (or one of its committees), the relevant person or entity is asked to refrain from taking part in the decision.

- 26 LME's regulation and compliance department is divided as a matter of policy by means of a Chinese wall between the commercial and marketing functions of the LME so as to preserve the confidentiality of sensitive member and client commercial information that is required for regulatory purposes.
- 27 Based on our review of all information at hand and information provided by LME and FSA, it appears that LME continues to have adequate arrangements for handling conflicts of interest. ASIC is not aware of any significant conflicts of interest events occurring during the assessment period.
- 28 The FSA has no information that would cause it to suspect or conclude that LME has not been meeting its arrangements for handling conflicts.

### **Monitoring market and participant conduct**

- 29 To maintain its status as a recognised investment exchange, LME is required by the FSA, among other things to:
- (a) maintain systems and controls to monitor transactions on the exchange;
  - (b) ensure that trading is conducted in an orderly and fair manner; and
  - (c) monitor compliance with its rules.
- 30 The FSA exercises its supervisory responsibility by conducting ongoing assessments of whether the LME's systems and controls adequately discharge the above and other requirements.
- 31 The LME rules are designed to enable the LME to fulfil its recognition obligations. In monitoring the conduct of participants, the rules require members to permit access to their premises and to relevant records to satisfy the LME that the members are in full compliance with the LME rules. Members are also required to forward information about their exchange-related activity to the LME upon request, and to cooperate with the exchange in providing information to regulatory bodies.
- 32 Supervision of LME's members is conducted by its Market Surveillance and Member Surveillance divisions, two of the three divisions comprising the LME's Regulation and Compliance Department (the third division being Enforcement).
- 33 The Market Surveillance division monitors trading to ensure that it is fair and transparent. Staff analyse trading data in conjunction with underlying trends in supply, demand and prices of underlying securities to detect any anomalies in the market. Concerns about

suspected abuses by a participant will be discussed with the participant and if necessary referred to the head of investigations for further scrutiny.

- 34 The Member Surveillance division conducts visits to ensure that the members' controls and procedures comply with the LME rules. Information that is required to be disclosed to LME is checked for accuracy and completeness, checks are performed to confirm that only accredited users access the LME Select electronic platform and that the necessary records are kept in accordance with LME and FSA requirements. Serious breaches of LME rules will be referred to the Head of Enforcement.
- 35 Based on our review of all information at hand and information provided by LME and FSA, LME appears to have adequate arrangements for monitoring the conduct of participants that are adequate for the nature of the market it operates.
- 36 The FSA has no information that would cause it to suspect or conclude that LME has not been meeting its obligations for monitoring participant conduct.

### **Compliance with market operating rules**

- 37 The market and member surveillance teams of LME refer any breaches of LME's operating rules to the enforcement division of LME's regulation and compliance department. The enforcement division investigate and prosecute any breaches. LME is required to notify the FSA of certain events.
- 38 Based on our review of all information at hand and information provided by LME and FSA, LME appears to have adequate arrangements for enforcing compliance with its operating rules.
- 39 The FSA has no information that would cause it to suspect or conclude that LME has not been meeting its obligations to enforce compliance with its operating rules.
- 40 No event has been brought to ASIC's attention where an Australian participant breached LME's operating rules.

## **Regulation of LME in the UK**

- 41 ASIC received information from the FSA about the regulation of LME during the assessment period.

- 42 The FSA has advised us that they are not aware of any information or instances indicating the inadequacy of LME's supervisory arrangements. The FSA also advised it has not taken any disciplinary action against LME during this reporting period.

## Reporting obligations

- 43 Under the Corporations Act and its licence conditions, LME is required to provide information to ASIC which includes but is not limited to:
- (a) the extent to which LME has complied with its obligations as a market licensee to ASIC; and
  - (b) the volumes and contracts traded on LME Select.

### Annual regulatory report

- 44 ASIC notes that LME lodged its s792F annual regulatory report with us in a timely manner.

### Reports required by market licence

- 45 LME's 6-monthly reports satisfied section 10(1)(a) to (c) of the market licence.

### Rule amendments

- 46 ASIC acknowledges that LME has provided notices on rule changes in a timely manner and with sufficient information to satisfy s793D(3) of the Corporations Act.

## Conclusion

- 47 Based on this assessment, ASIC does not have any recommendations to make about LME's current supervisory arrangements.

## Key terms

Term	Meaning in this document
AFS licence	Australian financial services licence under s911A
AML	Australian market licence under s791A
ASIC	Australian Securities and Investments Commission
FSA	Financial Services Authority (UK)
LME	The London Metal Exchange Limited
LME Select	An electronic trading system that facilitates trading in financial derivatives on a number of metals and plastics. Trading also takes place through open outcry and inter-office telephone systems.
Corporations Act	<i>Corporations Act 2001</i> (Cth)
s794C	A section of the Corporations Act (in this example numbered 794C)
UK	United Kingdom