



**ASIC**

Australian Securities & Investments Commission

**REPORT 161**

# **Market assessment report: EBS Service Company Limited**

**ARBN 107 465 967**

June 2009

## **About this report**

This report summarises ASIC's third assessment of EBS Service Company Limited (EBS) under s794C of the *Corporations Act 2001* (Corporations Act).

This assessment covers the period 1 January 2007 to 31 December 2007 (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 EBS

EBS was granted an Australian market licence to operate EBS Spot commencing 14 March 2005. The Australian market licence was varied with effect 21 December 2006.

| Report number | Date released |
|---------------|---------------|
| REP 73        | May 2006      |
| REP 104       | October 2007  |

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## Key findings and recommendations

### Key findings

- 1 ASIC is satisfied that EBS has:
  - adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act; and
  - sufficient resources to operate its markets properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.

### Recommendations

- 2 We recommend that EBS should review its internal procedures to ensure compliance with its notification obligations under the Corporations Act.

## A The assessment

### Key points

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

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

We use the licensee's self-assessment reports, information from our previous assessments, 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 Under s792A(c), a market licensee is required to have 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 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.
- 4 ASIC is required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year: s794C(2).
- 5 In addition, we are permitted to extend the scope of our assessment to review how well EBS complies with any or all of its obligations under Ch 7: s794C(1). As such, we have examined whether EBS has sufficient financial, technological and human resources to comply with its obligations under s792A(d).

### Background

#### EBS Service Company Limited

- 6 EBS is a Swiss incorporated subsidiary of EBS Group Limited. EBS Group Limited and its subsidiaries were acquired in June 2006, by ICAP plc, a company quoted on the London Stock Exchange.

- 7 The merger of these two entities has not affected the Australian market licence of EBS or its obligations as a market licensee.
- 8 From an operational perspective, EBS Group Limited and its affiliates, including EBS, (together, the EBS Group) are managed as a single group by the Executive Management Team made up of staff employed by affiliated companies EBS Dealing Resources, Inc., EBS Dealing Resources International Limited and subsidiaries of ICAP plc. In the case of EBS, the Executive Management Team provides recommendations to the directors of EBS, and if approved by the directors, these recommendations are implemented by the Executive Management Team.

### **The EBS market—EBS Spot**

- 9 On 14 March 2005, EBS was granted an Australian market licence under s795B(1), authorising it to operate the market known as EBS Spot in Australia. This Australian market licence was varied on 21 December 2006, to permit EBS to facilitate trading in two additional precious metals: palladium and platinum. A copy of the licence and licence variation are available on our website at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).
- 10 EBS Spot is an electronic deal-matching trading system that facilitates trading by participants in spot foreign exchange and precious metals (i.e. gold, silver, palladium and platinum). Operating a market to facilitate the trading of spot precious metals does not require a market licence in Australia. The trades are matched automatically by EBS Spot.
- 11 Trades occur on an anonymous basis with the identity of the counterparty unknown to the participants before the trade is executed. However the system will only match trades between participants who have previously established mutual credit limits with each other. All participants on EBS Spot must be wholesale clients as defined under s761G or act on behalf of wholesale clients.
- 12 In accordance with its Australian market licence, EBS commercially launched on 3 March 2008 non-deliverable forwards to be traded on EBS Spot. Non-deliverable forwards are short-term foreign exchange contracts in currencies which have restricted convertibility. Currently, the following currencies are available for non-deliverable forward trading on EBS Spot: Argentine peso (ARS), Chilean peso (CLP), Chinese renminbi (CNY), Colombian peso (COP), Korean won (KRW), Indian rupee (INR), Indonesian rupiah (IDR), Malaysian ringgit (MYR), Peruvian nuevo sol (PEN), Philippine peso (PHP), Russian Rouble (RUB) and Taiwan dollar (TWD).

## Our methodology

### Our assessment process

- 13 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.
- 14 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 that in our view need, or may need, to be addressed to ensure ongoing compliance.

### What we focused on for this assessment

- 15 Our focus in this assessment was to review how well EBS complied with its ongoing supervisory and reporting obligations as well as the adequacy of its resources under its market licence and the Corporations Act.

### What we considered

- 16 In conducting our assessment we:
- analysed information we received from and about EBS in the ordinary course of our dealings;
  - analysed information obtained from the media and EBS' website;
  - reviewed EBS' s792F annual regulatory report;
  - reviewed EBS' half-yearly reports to ASIC; and
  - considered how well EBS might comply with its obligations in the future.

### Consultation

- 17 Our findings and recommendations are set out in Section B of this report. EBS has had the opportunity to view and comment on a draft version of this report. Where appropriate, our findings in Section B reflect EBS' responses.

## B Our observations

### Key points

We consider that EBS' arrangements and resources for supervising its market are adequate, including arrangements for:

- handling conflicts between the commercial interests of the market licensee and the need for the market 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.

We also note that EBS has complied with its reporting obligations under the Corporations Act.

### Supervisory arrangements

- 18 We conclude that EBS has adequate arrangements and resources for the supervision of its market in accordance with its obligations under s792A(c).
- 19 Our conclusion is based on the assessment that we conducted and the following observations:
- ASIC is not aware of EBS substantially changing the arrangements it has in place for supervising the market from the description provided in its Australian market licence application;
  - no serious market failures or disruptions have come to our attention; and
  - during the assessment period no information came to our attention to suggest that the supervisory arrangements in place were not operating properly.

### Conflicts of interest

- 20 In its s792F annual regulatory report, EBS stated it is aware that there may be conflicts of interest between its commercial interests and its supervisory duties and has the following arrangements in place for managing such conflicts:
- (a) operating rules and written procedures that set out clear guidelines by which participants and EBS as a market licensee must operate;



- (b) written internal policies and procedures that specifically deal with issues arising from actual or potential conflicts of interest;
- (c) objective criteria used to determine whether an entity should be admitted as a participant of the market;
- (d) three Regional General Counsels are appointed and provided with the opportunity to identify conflicts of interest between EBS Group's commercial and supervisory obligations;
- (e) EBS' ultimate parent, ICAP plc, undertakes reference checks on new employees for possible conflicts of interest;
- (f) commercial and supervisory activities are separated structurally within the EBS Group (e.g. supervisory activities are generally undertaken at the ICAP plc level); and
- (g) any decisions in relation to disciplinary action would be made by ICAP plc's Executive Management Team in discussion with EBS.

- 21 We note that EBS Spot is restricted to participants who, it is reasonable to assume, understand the risks involved in the market and have the resources to adequately represent and protect their own interests.
- 22 EBS has submitted that there were no significant conflicts of interest events occurring during the assessment period.
- 23 We consider that EBS' arrangements for handling conflicts of interest are adequate taking into account the nature of the market and its participants.

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

- 24 In its s792F annual regulatory report, EBS submits its supervisory arrangements for monitoring the conduct of participants on and in relation to EBS Spot are adequate when the nature of EBS Spot and its participants are taken into account.
- 25 The nature of EBS Spot and participants on the market are as follows:
- (a) users of EBS Spot are highly sophisticated entities with a detailed understanding of the market and financial products in which they deal;
  - (b) each participating entity has previously satisfied itself as to the credit risk of its counterparty prior to entering any particular deal; and
  - (c) EBS Spot is a fully automated deal matching system.
- 26 Where possible EBS has incorporated operating rules into EBS Spot's IT system, making it difficult for participants to breach these operating rules. In its operating rules, EBS requires participants to self-monitor their compliance with EBS Spot's operating rules. EBS Spot participants are

required to appoint an employee in the role of Trading Floor Administrator who is then responsible for the participant's smooth operation of EBS Spot.

- 27 Under the operating rules, EBS has the right to access a participant's trading floor for the purpose of confirming that the participant is complying with the operating rules. EBS notes in its s792F annual regulatory report that it did not exercise its right to access the trading floor of any participant.
- 28 We consider EBS' arrangements for monitoring the conduct of participants are adequate for the nature of the market it operates.

### **Enforcing compliance with operating rules**

- 29 In its s792F annual regulatory report, EBS submits that it has continued to maintain the arrangements for enforcing compliance with operating rules which were outlined in its application for an Australian market licence. These arrangements include:
- (a) if a participant has breached or is in the process of breaching the EBS Customer Agreement or is not complying with the EBS Spot Dealing Rules, EBS may withdraw a participant's access to, or suspend EBS' provision of EBS Spot;
  - (b) EBS can request that a participant terminate an employee's access to EBS Spot if the employee is in breach of the EBS Spot Dealing Rules;
  - (c) EBS can remove any bid or offer from EBS Spot if the bid or offer breaches or contains material prohibited by the EBS Spot Dealing Rules, or if it is impairing or reducing the efficiency of the system; and
  - (d) under the operating rules each participant agrees that its obligations to comply with operating rules are legally enforceable against it by each other participant (as well as by EBS).
- 30 EBS states in its s792F annual regulatory report that it has not needed to exercise any of the above rights during the assessment period.
- 31 We consider that EBS has adequate arrangements for enforcing compliance with its operating rules in view of the arrangements listed in para 29, and taking into account the nature of the market and its participants.

## **Resources**

- 32 In our assessment, we also reviewed the adequacy of EBS' resources (including human, technical and financial resources) to operate the markets properly and to provide adequate supervisory arrangements.

## Financial resources

- 33 We have reviewed EBS' audited financial statements and consider that EBS has generated sufficient revenue each year to cover the costs of operating its market.

## Human resources

- 34 As of 31 December 2007, there were 224 full time employees in various locations around the world available to operate and manage ICAP Electronic Broking, which consists of a number of electronic business lines including EBS Spot. Apart from these employees, ICAP employees in support functions such as IT, Finance, Technology and Operations, and Human Resources are also available as specialist resources for the operation and management of EBS Spot.

## Technological resources

- 35 EBS submits that the current technology has coped with existing volumes on EBS Spot and there has been no serious market disruptions during the assessment period.
- 36 In its s792F annual regulatory report, EBS submits that it has upgraded its broker servers to realise significant performance improvements.
- 37 We conclude that EBS has sufficient resources to operate its market properly and to provide the required supervisory arrangements in accordance with its obligations under s792A(d) of the Corporations Act.

## Reporting obligations

### Annual regulatory report

- 38 EBS lodged with ASIC its s792F annual regulatory report for the period 1 January 2007 to 31 December 2007 on 31 March 2008. We note that this report was lodged within the required period and it contained the information required.

### Reports required by market licence

- 39 Under section 8 of its Australian market licence, EBS must lodge a report with ASIC every six months. The report must contain details of the volumes traded on the market in Australia and globally, and must list all Australian participants of the market.

40 ASIC notes that the section 8 reports for this assessment period contained the prescribed information.

### **Operating rule changes**

41 Under s793D(1), as soon as practicable after a change is made to the operating rules of a licensed market, the licensee must lodge with ASIC written notice of the change. Under s793D(2), if no notice is lodged with ASIC within 21 days after the change is made, the change ceases to have effect at the end of that period.

42 EBS amended its operating rules to accommodate the introduction of non-deliverable forward trading on EBS Spot in March 2008. We note that EBS failed to notify ASIC within 21 days after the operating rules were changed and as such these changes ceased to have effect after the end of that period.

43 However, EBS has submitted that the failure to notify ASIC of the operating rule changes was inadvertent. EBS also submitted that there has been no prejudice to the Australian market or participants, and the volume of trades for the non-deliverable forward product has been minimal.

44 EBS has now lodged the operating rule changes relating to the introduction of non-deliverable forward trading and they have been reviewed and sent to the Minister by ASIC.

### **Recommendations—notification obligations**

ASIC recommends that EBS reviews its internal procedures to ensure it complies with its notification obligations under the Corporations Act.

45 EBS has agreed to review its internal procedures to ensure compliance with its notification obligations under the Corporations Act.

## Key terms

| Term                | Meaning in this document   |
|---------------------|--|
| ASIC                | Australian Securities and Investments Commission   |
| Corporations Act    | The <i>Corporations Act 2001</i> (Cth)   |
| EBS                 | EBS Service Company Limited  |
| EBS Spot            | EBS' electronic anonymous deal-matching trading system that facilitates trading by participants in spot foreign exchange and precious metals |
| market licensee     | Holder of a s795B Australian market licence  |
| s794C (for example) | A section of the <i>Corporations Act 2001</i> (in this example, numbered 794C)   |