



**ASIC**

Australian Securities & Investments Commission

**REPORT 170**

# **Market assessment report: London Metal Exchange Limited**

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## **About this report**

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

This assessment covers the period 11 April 2008 to 15 April 2009 (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 LME

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

Report number	Date released
REP 147	December 2008

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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 We do 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 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 a licensee complies with any or all of its obligations under Ch 7: s794C(1).
- 6 This reports covers the period from 11 April 2008 to 15 April 2009 (the assessment period), although we have had regard to subsequent developments.

## Background

- 7 LME is a wholly owned subsidiary of LME Holdings Limited, a private limited company registered in England and Wales. LME operates the London Metal Exchange.
- 8 LME is a leading exchange for the trading of non-ferrous metals futures and options. It offers contracts on a range of commodities including aluminium, copper, tin, nickel, zinc, lead, aluminium alloy, steel billet and plastics. Trading on LME takes place via three avenues: open outcry; inter-office telephone system; and LME's electronic trading platform called LME Select.
- 9 LME Select received an upgrade in November 2008 to improve the system's robustness and, in doing so, offer better operational efficiency. In order to trade on LME Select it is necessary to be a ring dealing member or an associate broker clearing member of LME. There are five main categories of membership of LME. These are: ring dealing members; associate broker clearing members; associate trade clearing members; associate broker non-clearing members; and associate trade non-clearing members. Contracts traded on LME are cleared through LCH.Clearnet Limited.
- 10 Despite the volatile conditions in the global financial market LME managed to increase its annual trading volume by 22% in 2008. LME achieved volumes of over 113 million lots, representing just over US\$10,240 billion; which is equivalent to an average daily trading value of US\$40 billion.
- 11 LME's latest six-monthly regulatory report to ASIC (for the period ended 30 June 2009) indicates that the total trading volume from the three Australian market participants on LME Select from Australia was 34,592 lots (trading aluminium alloy, copper, nickel, lead, tin and zinc). This accounted for 0.27% of worldwide trading volume, which is up from the previous six months where trading volumes from Australian participants reached 0.23% of total worldwide volumes.
- 12 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).
- 13 LME is currently also authorised to operate in several other jurisdictions including the United States of America, Hong Kong, Japan and Singapore.

### Regulation of LME in Australia

- 14 LME is registered as a foreign company in Australia under the Corporations Act and is an overseas-based market operator. LME was granted its Australian market licence to operate LME Select under s795B(2) of the Corporations Act on 10 April 2007.

- 15 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.
- 16 LME requires all Australian participants to hold an Australian financial services (AFS) licence that permits them to trade in products equivalent to those that can be dealt with on the LME's market, unless the participant is exempted under Australian law from the requirement to hold an AFS licence to participate in the market.
- 17 LME's market licence is available on the ASIC website at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).

## Our methodology

### Our assessment process

- 18 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.
- 19 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 focused on for this assessment

- 20 Our focus in this assessment was to review how well LME complied with its ongoing supervisory and reporting obligations under its Australian market licence and the Corporations Act. The assessment covered the period from the 11 April 2008 to 15 April 2009.

### What we considered

- 21 In conducting our assessment we considered:

- information we received from and about LME in the ordinary course of our dealings with the licensee;
- LME's annual regulatory report required under s792F;
- information from the media, LME's website and other sources;
- LME's six-monthly regulatory reports to ASIC;
- additional information from LME for the purpose of this assessment;
- information from the FSA about the market and LME; and
- LME's financial report for year ended 31 December 2008.

### **Communication with the foreign regulator**

- 22 In assessing an overseas licensee's compliance with its obligations under s792A(c) of the Corporations Act, we place a degree of 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 LME remains a recognised investment exchange in 'good standing' with the FSA.

### **Consultation**

- 23 Our findings are set out in Section B of this report. LME has had the opportunity to view and comment on the factual accuracy of a draft version of this report. Where appropriate, our findings in Section B reflect LME's clarifications.



## B Our observations

### Key points

We consider LME's arrangements and resources for supervising its market are adequate, including its arrangements and resources 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.

LME did not make any substantial changes to its supervisory arrangements during the assessment period.

We do not have any recommendations to make in relation to LME's current supervisory arrangements.

We also note that LME's has complied with its reporting obligations under the Corporations Act.

### Supervisory arrangements

- 24 We conclude that LME has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 25 Our conclusion is based on the following observations drawn from information gathered during the 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 (see REP 147) have not changed during the assessment period;
  - the FSA confirmed that LME remains in good standing a recognised investment exchange, and that there was no disciplinary action taken against LME; and
  - during the assessment period nothing came to our attention to suggest that LME's supervisory arrangements are not operating properly.

## Managing conflicts of interest

- 26 As a recognised investment exchange in the United Kingdom, LME is required to manage conflicts of interest fairly, whether it is between LME and its customers or between its customers.
- 27 As a matter of policy LME's regulation and compliance department does not share information with its commercial and marketing departments.
- 28 LME has a committee which is constituted by independent non-conflicted persons appointed by the board of the LME. This committee has the power to take the necessary action to deal with any market emergency situations that may arise.
- 29 The FSA has indicated that it does not have any information that would cause it to suspect or conclude that LME has not been meeting its arrangements for handling conflicts.
- 30 LME has advised that its conflict of interest arrangements have not changed since being granted its market licence on 10 April 2007.

## Market and participant supervision

- 31 LME's regulation and compliance department is responsible for market and participant supervision. The department consists of three divisions: Market Surveillance, Member Surveillance, and Enforcement. Market Surveillance and Member Surveillance oversee supervision of LME members.
- 32 Market Surveillance's role is to protect the integrity of LME's market by monitoring trading. Staff analyse trading data and note any concerns about suspected market abuses. LME will then discuss this with the member concerned. If warranted a referral can be made to the head of investigations.
- 33 The Member Surveillance division working with Market Surveillance reviews members' controls and procedures and general compliance with LME's rules by conducting onsite visits to member firms. Checks are done on information disclosed to LME for accuracy and completeness. Checks are also performed to confirm that only accredited users are given access to LME Select and that the necessary records are kept in accordance with LME and FSA requirements. Serious breaches of LME's rules are escalated to the Head of Enforcement.
- 34 LME advised that no investigations were carried out into Australian participants during the course of the assessment.
- 35 The FSA does not have any information that would cause it to suspect or conclude that LME has not been meeting its obligations for monitoring members' conduct.

- 36 Based on our review of the information on hand and information provided by LME and the FSA, we are satisfied LME has adequate arrangements for monitoring the conduct of member given the nature of the market it operates.

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

- 37 The market and member surveillance divisions refer any breaches of LME's operating rules to the Enforcement division. The Enforcement division investigate and prosecute any breaches. LME is required to notify the FSA of certain events. During the assessment period LME took disciplinary actions in relation to nine breaches of the LME rulebook.
- 38 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.
- 39 On the basis of information available to ASIC and information provided by LME and the FSA, ASIC is satisfied LME has adequate arrangements for enforcing compliance with its operating rules.

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

- 40 We received information from the FSA about the regulation of LME during the assessment period.
- 41 The FSA indicated that LME continues to satisfy its recognition requirements and advised that it does not have any concerns about LME's compliance with its supervisory obligations. The FSA also advised it has not taken any disciplinary action against LME during the assessment period.

## **Reporting obligations**

### **Annual regulatory report**

- 42 We note that LME lodged its s792F annual regulatory report with ASIC in a timely manner with the required information.

### **Reports required by market licence**

- 43 We also note that LME lodged its six-monthly reports with us on time and these contained the information required.

### **Rule amendments**

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

### **Conclusion**

- 45 Based on this assessment, we do 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
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
FSA	Financial Services Authority (UK)
LME	The London Metal Exchange Limited
LME Select	The LME's electronic trading system
s794C	A section of the Corporations Act (in this example, numbered 794C)