



ASIC

Australian Securities & Investments Commission

REPORT 172

Market assessment report: BGC Partners (Australia) Pty Limited

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About this report

This report summarises ASIC's second annual assessment of BGC Partners (Australia) Pty Limited (BGCA) under s794C of the *Corporations Act 2001* (Corporations Act).

This assessment covers the period 1 September 2007 to 31 August 2008 (the 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 BGCA

BGCA was granted an Australian market licence on 27 September 2006.

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Key findings and recommendations

Key findings

- 1 ASIC is satisfied that BGCA 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 market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.

Recommendations

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

A The assessment

Key points

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

The scope of our assessment must include the obligations found in s792A(c), but we can include other Chapter 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 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 BGCA complies with any or all of its obligations under Chapter 7: s794C(1). In this instance, we extended the scope of the assessment to include a review of whether BGCA had sufficient financial, technological and human resources to comply with its obligations under s792A(d).
- 6 This assessment covers the period 1 September 2007 to 31 August 2008.

Background

- 7 BGCA is a proprietary company wholly owned by BGC Global Holdings L.P., a foreign limited partnership.

- 8 BGCA was granted an Australian market licence on 27 September 2006 to operate a market trading in Australian Government bonds, semi-government bonds, corporate bonds and debentures, and New Zealand Government bonds, using the eSpeedsm electronic trading system. The participants on the BGCA market are professional investors as described in Section 7 of BGCA's market licence. As at 31 December 2008, BGCA had 10 Australian participants operating on its market.
- 9 BGCA operates a 'hybrid' market model whereby trading is facilitated both on screen and off screen via voice broking. In relation to on screen orders, a trade is facilitated when a bid or offer is entered by a participant (or BGCA broker on behalf of a participant) to meet an existing bid or offer. Alternatively, a participant (or BGCA broker) can enter a price into the platform which a counterparty will have the opportunity to 'hit' establishing price discovery however not fulfilling a trade.
- 10 Off screen (voice only) orders are broadcast to all participants as per the normal market convention for over-the-counter voice brokered trades. Voice only orders may at any time be placed into the electronic trading system by a BGCA broker on participant instruction, either to be worked simultaneously in both markets or individually in the electronic market only.
- 11 In the over-the-counter financial markets, the total turnover of Australian Government debt securities and non-government debt securities for the 2007–2008 period was \$716 billion and \$637 billion, respectively.¹
- 12 On 1 April 2008 BGC Partners, a global full-service inter-dealer broker of financial instruments, and eSpeed, Inc., a developer and provider of electronic marketplaces and related trading technology for global capital markets announced that eSpeed and BGC Partners had completed their merger. The combined company is BGC Partners, Inc. (NASDAQ: BGCP) which owns BGC Global Holdings L.P.
- 13 During the assessment period, in addition to an Australian market licence, BGCA held an Australian financial services (AFS) licence authorising it to carry on a financial services business to wholesale clients for certain financial products. This assessment of BGCA does not cover BGCA's compliance with its AFS licence obligations.
- 14 A copy of BGCA's market licence and the terms of its AFS licence are available on ASIC's website at www.asic.gov.au/markets.

¹ Australian Financial Markets Association, *2008 Australian Financial Markets Report*.

Our methodology

Our assessment process

- 15 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.
- 16 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

- 17 Our focus in this assessment was to review:
- how well BGCA complied with its ongoing supervisory obligations under its Australian market licence and the Corporations Act during the assessment period;
 - the changes made by BGCA in response to the issues we identified in our previous assessment; and
 - the adequacy of BGCA's financial, technological and human resources to operate and supervise its market.

What we considered

- 18 In conducting our assessment of BGCA we considered:
- BGCA's 2007 annual regulatory report provided by BGCA under s792F of the Corporations Act;
 - other reports provided by BGCA in accordance with Section 8 of BGCA's licence conditions;
 - information we received from and about BGCA in the ordinary course of our dealings with BGCA as a market licensee;
 - BGCA's response to our notice under s30 of the *Australian Securities and Investment Commission Act 2001* (Cth) to obtain information about how BGCA is meeting certain obligations under the Corporations Act;
 - information we received during our visit to BGCA's office between 30 July 2008 and 1 August 2008, where we conducted interviews with BGCA's Compliance Manager, Hong Kong and Australia (now

Compliance Manager, Asia), Australian Compliance Manager, Director of eCommerce Asia and two brokers; and

- BGCA's policies and procedures for the conduct of BGCA in general and its supervisory responsibilities in particular.

Consultation

- 19 Our findings are set out in Section B of this report. BGCA 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 BGCA's clarifications.

B Our observations

Key points

We consider that BGCA's arrangements for supervising its market are adequate, including arrangements for:

- handling conflicts between its commercial interests and the need 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 do not have any recommendations to make in relation to BGCA's current supervisory arrangements.

Supervisory arrangements

- 20 We conclude that BGCA has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 21 In our previous assessment, while we concluded that BGCA had adequate arrangements for supervising its market, we recommended improvements to those arrangements, in particular, in relation to the functions of the brokers, help desk and compliance. This year's assessment included a review of the changes made by BGCA in response to those recommendations.
- 22 Our previous assessment reviewed BGCA's multi-tiered system of supervision in which BGCA brokers, help desk and compliance staff were responsible for ongoing compliance monitoring and supervision. However, during the on-site phase of our assessment, it became apparent that there was some confusion as to who was specifically responsible for matters such as ongoing review of trading, market operations and investigations. We also observed that the help desk was purely providing technical support and as such not taking an active role in monitoring compliance in the market.
- 23 In response to the recommendations made by ASIC in the previous assessment, BGCA conducted a thorough review of its system of supervision. As a result of this review, a number of changes have been made, including the transference of the help desk's supervisory role to compliance, enhancements to the supervisory role of the brokers (including requiring brokers to be able to identify and report activity by participants that could frustrate the orderly operation of the electronic market and/or mislead or

cause market confusion), the mandatory recording of trades on trade sheets and updates to BGCA's compliance manual.

- 24 In addition, BGCA is now providing its brokers with training on an individual basis, as and when required, to ensure understanding of the new procedures. This includes brokers being made aware of the issues they need to look out for and their reporting responsibilities. While no formal training programs had been developed, changes to BGCA's compliance manual require compliance to ensure that all brokers undertake one hour of training in relation to market supervisory issues and one hour of training in relation to conflicts every six months. Compliance is required to report monthly in relation to training undertaken during the month and training scheduled for the following month.
- 25 In relation to reporting, BGCA now has integrated additional reporting requirements into its compliance manual. Compliance is now required to report weekly, monthly and quarterly on supervisory issues including results of spot checks (which are discussed in more detail below) and investigations, training and system issues and cancellations reported by the help desk. The compliance manual also details the information to be included in the half yearly and yearly reports to ASIC.
- 26 We consider that BGCA's updated procedures relating to training and reporting are adequate. However given that they were in their infancy during the assessment period and have therefore not yet been fully tested, we will check to see whether they are being followed in our next assessment. Our focus will be on how brokers carry out their supervisory role including how they identify activity by participants that could frustrate the orderly operation of the electronic market and/or mislead or cause market confusion. We will also review compliance's engagement with the brokers and their response to any issues identified and reported by brokers.

Managing conflicts of interest

- 27 During our assessment, we reviewed BGCA's system of supervision in which broking and compliance staff are used to monitor its actions on and in relation to the market, and the actions of participants, to ensure that conflicts of interest are avoided or resolved if they are discovered. This included a review of BGCA's policies, procedures and resources that allow BGCA to effectively meet and monitor its ongoing obligations in relation to conflicts of interest.
- 28 BGCA's Conflicts Policy Statement (conflicts policy) identifies a number of conflicts of interest that may arise, including proprietary trading, insider trading and preferential treatment of higher brokerage clients. BGCA's Australian Compliance Manager is required to review the conflicts policy on a six-monthly basis. On completion of the review the BGCA Board is

provided with a summary of the non-conformances and/or breaches and any recommendations to amend the policy. The Board is then required to consider the recommendations and determine whether any of the proposed amendments are necessary.

- 29 BGCA's conflicts policy has been regularly reviewed by compliance staff and no changes have been made to date. We conclude that the policy is sufficient to cover BGCA current business.
- 30 BGCA's 'hybrid' market model allows BGCA brokers to enter trades on behalf of clients directly into the market, while also operating a traditional over-the-counter voice broking business.
- 31 During the previous assessment, although we did not find any evidence of inappropriate distribution of information, we noted the possibility of a conflict of interest given that BGCA's businesses were operating side-by-side. It appeared that there was little separation of the sales role and supervisory functions for the broking staff and there were no processes for monitoring trades and brokers' transactions. Hence, we recommended that BGCA make relevant changes to its written procedures, guidelines and education program for conflicts of interest, particularly relating to the activity of its brokers.
- 32 Since the last assessment BGCA has developed more robust monitoring procedures whereby brokers are required to maintain detailed trade order sheets for all orders they receive. These trade sheets are to contain details such as client name, volume of order, price, direction (buy/sell), time of order and method of execution (on screen or off screen). These trade sheets are randomly reviewed by compliance staff and compared with the trading platform logs and telephone records to monitor broker behaviour and ensure that orders are entered in a timely and sequential manner.
- 33 We have reviewed a sample of the new trade sheets and in our view they capture enough information to enable compliance staff to conduct their trade sheet checks (spot checks).
- 34 BGCA's updated compliance manual sets out the supervisory duties and reporting responsibilities of compliance staff and the brokers. The manual details how the compliance spot checks and other supervisory functions are carried out and requires compliance staff to investigate all issues reported by the help desk and the brokers. Compliance staff are required to report monthly to management regarding the results of its spot checks, any issues identified by the help desk and the brokers and any investigations undertaken as a result.
- 35 BGCA informed us that one-on-one training had taken place between compliance staff and brokers to ensure brokers were now aware of how to avoid/resolve conflicts of interests, the importance of transparency and the

reasons behind the updated procedures. This was confirmed during the on-site phase of our assessment when it became evident to us that brokers were more aware of conflicts of interest issues, the updated procedures and the reasons for the updates. In addition, it appeared to us that the new procedures were being followed.

Monitoring the conduct of participants

- 36 BGCA's operating rules state that all participants are responsible for the accuracy of details and the integrity and authenticity of all information, bids and offers that are submitted to the market (operating rule 2.1(c)). In addition, participants are responsible for making their own arrangements for the clearing and settling of transactions (operating rule 4).
- 37 In accordance with operating rule 2.3 participants must appoint a compliance officer who will be responsible for internal training and supervision of all staff entering trades via the market, including supervising compliance with the client agreements and the market operating rules.
- 38 Electronic Trading Guidelines are incorporated into and form part of the market's operating rules. These guidelines govern trading on the eSpeedsm electronic trading system and stipulate, among other things, minimum size trades and rules relating to EFP trades, switch trades and error trades. Under these guidelines, BGCA may cancel a transaction in certain circumstances, including if the price was entered in a manner judged by BGCA to mislead or cause market confusion and/or if the price of the transaction materially and clearly deviated from the mid-market price prevailing at the time the transaction was effected. In respect of the latter, the guidelines provide guidance as to the amount of deviation that would justify BGCA cancelling such a trade.
- 39 In addition, the electronic trading guidelines state that the regular posting of orders in minimum size to better an existing price followed by the withdrawal of the better price and substitution by a substantially worse (and out of market) price which appears to have the primary purpose of frustrating the orderly operation of the electronic market and other participants use of the electronic trading system and/or to mislead or cause market confusion entitles BGCA to cancel a trade.
- 40 BGCA brokers are required to monitor and report to BCGA's Australian Compliance Manager or, if he is not available, the Compliance Manager Asia, the Director of eCommerce Asia or the Director of Compliance Europe and Asia, all breaches and possible breaches of the operating rules by participants, suspected false and misleading conduct by BGCA or participants, and any other suspected problems or issues that affect the operation of the market. This obligation on brokers means they would need

to report activity described in paragraphs 38 and 39 that would entitle BGCA to cancel a trade.

41 In the previous assessment we also noted that while the help desk held a list of clients and personnel authorised to access the trading platform, there did not appear to be a protocol in place to regularly check the list. The updated compliance manual now requires the help desk to maintain an up to date list of participants authorised to access the market. Help desk is required to report monthly to compliance staff with an up-to-date list identifying new users and the parties no longer authorised to access the market.

42 We are satisfied that BGCA has adequate arrangements for monitoring the conduct of its participants with its market operating rules.

Enforcing compliance with the operating rules

43 Operating rule 2.1(a) states that all participants of the market must comply with the market's operating rules. Operating rule 1.5 gives BGCA the right to take disciplinary action to terminate or suspend a participant in the market if they breach an operating rule.

44 Under operating rule 1.1, a participant must enter into a client agreement which provides that a participant agrees that the market's operating rules form part of the agreement and are the basis on which all trades on the system are entered into and all other dealing activities on the system are carried out. This agreement gives BGCA the right to limit or terminate a participant's access to the system and to accept, reject or check any bid, offer, order or other request by a participant.

45 According to BGCA there were no changes to the operating rules during the assessment period.

46 BGCA's compliance manual states that all breaches of the operating rules must be brought to the attention of the Director of eCommerce Asia and the Australian Compliance Manager who will be responsible for deciding whether the breach should result in disciplinary action being taken against the participant. The BGCA Director of Compliance Europe and Asia makes the final determination in relation to the termination of a participant's participation in the market.

47 BGCA informed us that no breach or potential breach of the operating rules was identified. During our assessment we did not find any evidence to suggest otherwise.

Resources

48 In our assessment, we also reviewed the adequacy of BGCA's resources (including financial, technological and human resources) to operate the market properly and to provide adequate supervisory arrangements.

49 We conclude that BGCA 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.

Financial resources

50 BGCA has access to adequate financial resources to continue to operate the market.

51 A letter of financial support provided by BGC Global Holdings L.P. for the year ended 31 December 2006 was not required for the year ended 31 December 2007 as BGCA's current assets exceeded current liabilities.

Technological resources

52 BGCA's technology has coped with existing volumes on the market and no serious market disruptions have occurred.

53 Following the assessment period, BCGA upgraded and re-branded its electronic trading platform. According to BGCA the changes were aimed at providing greater functionality in addition to an improved 'look and feel' to the trading platform.

Human resources

54 BGCA's Australian Compliance Manager left in August 2008. From that time until a replacement was found in November 2008 this role was performed by the Compliance Manager Hong Kong and Australia.

55 We note that BGCA's help desk staff consists of only one person. This appears adequate for the operation of the market and bearing in mind the re-assignment of the help desk's supervisory function to compliance staff.

56 BGCA has sufficient staff employed in various capacities for commercial, supervisory and technological functions.

Conclusion

57 Based on our assessment, we do not have any recommendations to make in relation to BGCA's current supervisory arrangements.

Key terms

Term	Meaning in this document
AFS licence	An Australian financial services licence under s913B
ASIC	Australian Securities and Investments Commission
Australian market licence	Australian market licence under s791A
BGCA	BGC Partners (Australia) Pty Limited
Corporations Act	The <i>Corporations Act 2001</i> (Cth)
market licensee	Holder of a s795B Australian market licence
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)