



ASIC

Australian Securities & Investments Commission

REPORT 183

Market assessment report: BGC Partners (Australia) Pty Limited

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About this report

This report summarises ASIC's third 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 2008 to 31 August 2009 (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.

Report number	Date released
REP 120	February 2008
REP 172	September 2009

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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 the licensee 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 2008 to 31 August 2009.

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 14 September 2009, BGCA had 14 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 2008–09 period was \$792 billion and \$494 billion, respectively.¹
- 12 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.
- 13 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.

Our methodology

Our assessment process

- 14 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.
- 15 We therefore use the assessment process to:

¹ Australian Financial Markets Association, *2009 Australian Financial Markets Report*.

- 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

16 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;
- review the adequacy of BGCA's financial, technological and human resources to operate and supervise its market; and
- ascertain whether the changes made to BGCA's processes and procedures referred to in the previous assessment (REP 172) have been implemented.

What we considered

17 In conducting our assessment of BGCA we considered:

- BGCA's 2008 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 Investments 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 on 17 and 18 September 2009, where we conducted interviews with BGCA's Compliance Manager Asia (now Regional 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

- 18 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

- 19 We conclude that BGCA has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 20 As stated in our previous assessment report (REP 172), in response to recommendations made by ASIC in REP 120, BGCA conducted a thorough review of its system of supervision. As a result, a number of changes were made including the transfer of the help desk's supervisory role to compliance, enhancements to the supervisory role of the BGCA brokers, the mandatory recording of trades on trade sheets and updates to BGCA's compliance manual.
- 21 In addition, the changes require BGCA brokers to undertake one hour of training on market supervisory issues and one hour of training in relation to conflicts every six months. Compliance now maintains a training register and reports to management monthly on the training undertaken during the month and training planned for the future.
- 22 Compliance is now reporting weekly, monthly and quarterly on supervisory issues including results of trade sheet checks (spot checks) and 'outlier' checks (see paragraph 35 below) and any resulting investigations. Compliance also reports on training and system issues and cancellations reported by the help desk.
- 23 During the onsite phase of our assessment we observed that compliance and the BGCA brokers are working together to ensure that BGCA has an adequate system of supervision. The obligations of each are clearly set out in various documents such as the compliance manual and operating rules and discussed between compliance and the BGCA brokers on a regular basis.

Whilst no supervisory issues have arisen at BGCA, the processes and reporting lines are clear and adequate.

Managing conflicts of interest

- 24 In our previous assessment report (REP 172) we discussed how BGCA monitors (via its broking and compliance staff) its ongoing obligations to manage conflicts of interest. We also discussed BGCA's Conflicts Policy Statement (conflicts policy), which identifies and sets out the arrangements BGCA has in place to deal with potential conflicts of interests.
- 25 BGCA's conflicts policy is reviewed by the Australian Compliance Manager every six months. Reports provided by BGCA confirm that this review involves a survey with representatives of BGCA to consider possible additional conflicts encountered throughout the preceding six-month period and the effectiveness of existing arrangements. This also involves a review of complaints received, if any, raising new or existing conflicts. During the assessment period, BGCA reviewed the conflicts policy in January 2009 and June 2009 and, as a result, no changes were made to the policy. In our view BGCA's conflicts policy is sufficient to cover BGCA's current business and the process by which BGCA reviews the policy is appropriate.
- 26 BGCA's 'hybrid' market model allows the BGCA brokers to enter trades on behalf of clients directly into the market, while also operating a traditional over-the-counter voice-broking business. In such a situation, as the businesses are operating side by side, it is possible for conflicts of interest to arise.
- 27 BGCA manages potential conflicts of interest by requiring the BGCA brokers to maintain detailed trade sheets for all orders they receive. Compliance conducts spot checks of these trade sheets and any issues or investigations resulting from the spot checks are required to be reported to management.
- 28 BGCA has reported that no conflicts of interest have arisen during the assessment period.
- 29 We reviewed the BGCA brokers' trade sheets, compliance's 'Monthly Trade Check' sheets (which record the results of the spot checks) and compliance's reports to management. We are satisfied that BGCA's monitoring of trades as set out in the compliance manual is being followed and is adequate.
- 30 BGCA provides training to BGCA brokers to ensure they are aware of how to avoid and/or resolve conflicts of interests. This training is recorded in compliance's training register and is detailed in monthly reports to management.

Monitoring the market and conduct of participants

- 31 In accordance with BGCA's operating rules, market 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 and for making their own arrangements for the clearing and settling of transactions. Further, participants are required to 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.
- 32 Electronic Trading Guidelines which are incorporated into and form part of the market's operating rules govern trading on the eSpeedsm electronic trading system. Under these guidelines, BGCA may cancel a transaction in certain circumstances, including:
- (a) if the price was entered in a manner judged by BGCA to mislead or cause market confusion;
 - (b) if the price of the transaction materially and clearly deviated from the mid-market price prevailing at the time the transaction was effected. In this respect guidance is provided as to the amount of deviation that would justify BGCA cancelling such a trade (10% basis point error); and
 - (c) 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 misleading or causing market confusion.
- 33 In addition to the price differential guidelines outlined above, BGCA relies on the experience of the BGCA brokers and the participants of the market to identify unusual activity or activity likely to mislead or cause market confusion. The brokers have a duty to check pricing and report any issues to compliance. In addition, the participants are a limited number of professional investors who regularly trade on this market and understand the importance of the integrity of the system.
- 34 BGCA brokers are required to monitor and report to BGCA's Australian Compliance Manager or, if he is not available, the Regional 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 requires them to report that type of activity described above that would entitle BGCA to cancel a trade.

- 35 As part of the monitoring procedure, the Australian Compliance Manager reviews the trading system's trading log to identify any orders, by either a broker or market participant, that are outside the allowable limits, as outlined in the Electronic Trading Guidelines. The trading log is compared with the prevailing market prices and any prices entered into the system outside the allowable limits are investigated. This review takes place on a monthly basis. A 'Monthly Outliers Report' is prepared by the Australian Compliance Manager and forwarded to the Regional Compliance Manager Asia and the Director of eCommerce Asia as part of its monthly report to management.
- 36 BGCA is entitled to terminate or suspend a participant in the market in the event they breach the market's operating rules. In addition, BGCA has the right to limit or terminate a participant's access to the trading system and to accept, reject or check any bid, offer, order or other request by a participant, in accordance with client agreements that participants are required to enter into.
- 37 BGCA has informed us that during the assessment period there were no disputes between participants and no disputes between BGCA and participants regarding trading and compliance with operating rules.
- 38 The help desk maintains an up-to-date list of participants authorised to access the market and reports monthly to compliance identifying new users and the parties no longer authorised to access the market. In the event that a participant leaves the market, the Australian Compliance Manager makes enquiries to ascertain the reason and will investigate the issue if necessary.
- 39 We are satisfied that BGCA has adequate arrangements for monitoring the conduct of BGCA's market and its participants.

Enforcing compliance with the operating rules

- 40 ASIC notes there were no changes to the operating rules during the assessment period.
- 41 All breaches of the operating rules are required to be brought to the attention of the Director of eCommerce Asia and the Australian Compliance Manager, who are responsible for deciding whether disciplinary action should be taken against the participant (such as that referred to in paragraph 36 above). 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.
- 42 BGCA informed us that no breach or potential breach of the operating rules was identified. During our assessment we did not identify any breaches or potential breaches of the operating rules. ASIC is satisfied with BGCA's arrangements to monitor compliance with the operating rules.

Resources

- 43 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.
- 44 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

- 45 We have reviewed BGCA's financial position and are satisfied that BGCA has adequate financial resources to operate its market. BGCA's parent entity, BGC Global Holdings L.P., has also confirmed that it will continue to provide BGCA with financial support to enable it to meet its financial obligations.

Technological resources

- 46 BGCA's technology has dealt adequately with existing volumes on the market and no serious market disruptions have occurred.
- 47 In the previous assessment we reported that BCGA had upgraded and re-branded its electronic trading platform. The changes were aimed at providing greater functionality in addition to an improved 'look and feel' to the trading platform. All participants of the market are now using the upgraded platform and BGCA informs us that feedback has been positive.

Human resources

- 48 During the assessment period, BGCA relied on its Australian Compliance Manager, Regional Compliance Manager Asia and BGCA brokers to perform the required supervisory functions for the market. In our view this resourcing is sufficient.

Conclusion

- 49 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	<i>Corporations Act 2001</i> (Cth)
market licensee	Holder of an Australian market licence
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C)