



ASIC

Australian Securities & Investments Commission

REPORT 188

Market assessment report: CME Group Inc.

**Board of Trade of the City of Chicago Inc.
ARBN 110 594 459**

**Chicago Mercantile Exchange Inc.
ARBN 103 432 391**

January 2010

About this report

This report summarises ASIC's fourth annual assessment of Board of Trade of the City of Chicago Inc. (CBOT) and our sixth annual assessment of Chicago Mercantile Exchange Inc. (CME) under s794C of the *Corporations Act 2001* (Cth) (Corporations Act).

These assessments cover the period 21 July 2008 to 11 September 2009.

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 CBOT and CME

CBOT and CME were each granted an Australian market licence (market licence) to operate an overseas market in Australia on 7 December 2005 and 23 December 2003 respectively. The market licence for CME was varied with effect from 31 January 2008.

CBOT report number	Date released
REP 92	March 2007
REP 103	March 2008
REP 145	January 2009
CME report number	Date released
REP 52	August 2005
REP 72	May 2006
REP 92	March 2007
REP 102	March 2008
REP 144	January 2009

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Key findings and recommendations

Key findings

- 1 ASIC is satisfied that CBOT and CME (CME Group) have adequate arrangements for the supervision of their markets in accordance with their obligations under s792A(c) of the Corporations Act.

Recommendations

- 2 We do not have any recommendations to make about CME Group's current supervisory arrangements.

A The assessment

Key points

ASIC conducts annual assessments of market licensees, such as CBOT and CME, 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 its previous assessments, our observation of the licensee's performance, market intelligence and other things to form a view of how well a licensee has operated its market.

Purpose and scope

- 3 Under s792A(c) of the Corporations Act, 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 We are 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 21 July 2008 to 11 September 2009 (the assessment period), although we have had regard to subsequent developments.

Background

- 7 CBOT and CME are wholly owned subsidiaries of CME Group Inc. CME Group Inc. is a combined entity formed by the 2007 merger of CBOT Holdings and CME Holdings.

- 8 CBOT and CME are each registered to operate in the United States with the Commodity Futures Trading Commission (CFTC) as a designated contract market (DCM).
- 9 CBOT and CME are self-regulating bodies governed by their respective certification of incorporation, by-laws, rules and regulations.
- 10 Following the merger to form CME Group Inc., CBOT and CME remained separate self-regulating bodies. However, both sets of rules were harmonised, making the rules parallel in structure, numbering and language where possible.
- 11 In January 2008, CBOT's trading platform changed from e-cbot to CME Globex—the trading platform used by CME.

Regulation of CME Group in Australia

- 12 CBOT and CME are registered in Australia as foreign companies under the Corporations Act. Their market licences were granted pursuant to s795B(2) to operate their overseas financial markets in Australia.
- 13 The criteria under s795B(2) include a requirement that the regulatory regime of the foreign country, in this instance being the CFTC, is sufficiently equivalent in terms of investor protection and market integrity outcomes to the Australian regulatory regime.
- 14 While CME Group is required to comply with its obligations under the Corporations Act and its market licences, ASIC places a degree of reliance on the regulatory regime imposed by the CFTC.
- 15 CME Group's market licences permit it to operate markets in the financial products described in its licences. The class of financial products traded on these markets includes derivatives such as futures contracts and options over a range of underlying assets or indices.
- 16 Any Australian participants trading on CME Group's markets are required to hold an Australian financial services (AFS) licence, unless exempted under the Corporations Act.
- 17 Our reports on CME Group for the preceding period to 21 July 2008 were published on the ASIC website on 14 January 2009: *Market assessment report: Board of Trade of the City of Chicago Inc.* (REP 145) and *Market assessment report: Chicago Mercantile Exchange Inc.* (REP 144).
- 18 CME Group's market licences are available on our website at www.asic.gov.au/markets.

Our methodology

Our assessment process

- 19 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.
- 20 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

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

What we considered

- 22 In conducting our assessment, we considered:
- information we received from and about CME Group in the ordinary course of our dealings with the licensees;
 - CME Group's annual regulatory reports required under s792F;
 - information from the media, CME Group's website and other sources;
 - CME Group's six-monthly regulatory reports to ASIC;
 - additional information from CME Group for the purpose of this assessment;
 - information from the CFTC about the market and CME Group; and
 - CME Group's financial report for year ended 31 December 2008.

Communication with the foreign regulator

- 23 In assessing an overseas licensee's compliance with its obligations under s792A(c), we place reliance on statements by the licensee's home regulator about the standing of the licensee.
- 24 We have received confirmation from the CFTC that CME Group remains a DCM in 'good standing' with the CFTC.

Consultation

- 25 Our findings are set out in Section B. CME Group 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 CME Group's clarifications.

B Our observations

Key points

We consider CME Group's arrangements for supervising its markets 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.

CME Group 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 CME Group's current supervisory arrangements.

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

Supervisory arrangements

- 26 We conclude that CME Group has adequate arrangements for the supervision of its markets in accordance with its obligations under s792A(c).
- 27 Our conclusion is based on the following observations drawn from information gathered during our assessment process, our observations from our ongoing correspondence with CME Group, and the present operating conditions (including trading volumes and financial products traded on the markets):
- CME Group confirmed that, during the assessment period, arrangements for supervising its markets had not changed and there had been no disciplinary action taken against it by the CFTC;
 - the CFTC confirmed that it had no information indicating the inadequacy of CME Group's arrangements for supervising its markets; and
 - during the assessment period, nothing came to our attention to suggest that CME Group's supervisory arrangements were not operating properly.

Managing conflicts of interest

- 28 Core principle 15 of s5(d) of the US *Commodity Exchange Act* (CEA) requires DCMs to establish and enforce rules to minimise conflicts of interest in the decision-making process and establish a process for resolving such conflicts.
- 29 Chapters 2 and 4 of the CME Group rules provide the arrangements for managing conflicts of interest. Any relevant person or entity must disclose whether they are identified by name as a subject of any matter being considered by a committee, or whether they have, or may have, a financial interest in the outcome of that matter. Such a person or entity may be required to abstain from the deliberations of the committee (i.e. the board or body authorised to issue disciplinary charges). Furthermore, CME Group must prepare written records to document that the conflicts determination procedures required by the rules regarding the avoidance of conflicts of interest have been followed.
- 30 Based on our review of all information at hand and information provided by CME Group and the CFTC, we are satisfied that CME Group continues to have adequate arrangements for handling conflicts of interest. We are not aware of any conflicts of interest events occurring during the assessment period.
- 31 The CFTC has no information that would cause it to suspect or conclude that CME Group does not have adequate arrangements for handling conflicts.

Market and participant supervision

- 32 Core principle 2 of s5(d) of the CEA requires CME Group to monitor and enforce compliance with its rules. Chapter 4 of the rules provides for the enforcement of trading rules to ensure fair and equitable trading and for having the capacity to detect, investigate and discipline any person that violates the rules.
- 33 The self-regulatory responsibilities of CME Group include the procedures to recognise and, to the extent possible, prevent disruptions of the market. CME Group, through its Market Surveillance Department (MSD) within the Division of Market Regulation (DMR), is responsible for ensuring that participants in the marketplace do not interfere with the normal price discovery mechanism. The obligation to deter abusive practices is fulfilled through an ongoing program of market observation coupled with an active enforcement process that is continually reviewed for timeliness and effectiveness.
- 34 The DMR is responsible for detecting, investigating and prosecuting trade practice violations. The DMR's compliance systems provide data processing support for CME Group's investigative activities. Regulatory program investigators are responsible for monitoring compliance with Ch 4 of the

rules regarding dual trading, trading within broker associations, top step trading restrictions and out-trade assignments.

- 35 Data analysts conduct audit trail reviews of trading records and clearing submissions to determine whether required information is being properly recorded and accurately reported to CME Group. CME Group's daily investigators analyse exception reports and conduct analysis of cleared trades and other data to detect potential trading violations with respect to Globex trading. Where a trading activity is identified that may violate a rule, the matter is referred for further investigation. Once an investigation is concluded, the matter may be referred to the disciplinary committee.
- 36 The Division of Market Oversight (DMO) of the CFTC completed a rule enforcement review of CME Group's market surveillance program for:
- (a) compliance with preventing manipulation, price distortion, and disruptions of the delivery or cash settlement process; and
 - (b) enforcing its speculative position limits and position accountability rules.
- 37 The DMO's review has not identified any inadequacies in the compliance program for CME Group and has concluded that CME Group has complied with its self-regulatory responsibilities.
- 38 Based on our review of all information at hand and information provided by CME Group and CFTC, we are satisfied that CME Group has adequate arrangements for monitoring the conduct of participants.
- 39 The CFTC does not have any information that would cause it to suspect or conclude that CME Group does not have adequate arrangements for monitoring the conduct of participants on or in relation to the markets.

Compliance with market operating rules

- 40 Core principle 2 of s5(d) of the CEA requires CME Group, as a DCM, to establish and enforce rules for the discipline, suspension and expulsion of members or market participants that violate those rules.
- 41 Chapter 4 of the rules provides for the enforcement of rules and disciplinary action against members for failure to comply with the rules of CME Group.
- 42 The Managing Director of Regulatory Affairs has the duty of enforcing the rules, while utilising the facilities of the DMR to conduct investigations of rule violations and market conditions.
- 43 The Managing Director has the authority to inspect the books and records of all participants and may require any participant to produce their books and records to answer questions regarding possible violations of the rules.

- 44 The DMR assists the Managing Director and conducts trade practice reviews, investigations, data assurance audits, large trade surveillance, and some systems development. It also administers the member and customer arbitration forums and acts as prosecutor when disciplinary hearings are conducted against CME Group, clearing members, individual members or clerks.
- 45 The Probable Cause Committee receives and reviews investigation reports from the DMR. It is empowered to determine whether there is a reasonable basis to charge a rule violation and is responsible for the preparation of such charges.
- 46 The Business Conduct Committee has jurisdiction over the conduct of, and enforcement of the rules relating to, trading practices, sales practices and trading ethics of participants and others. It has the power to conduct hearings and investigations.
- 47 If a CME Group member is found guilty of a major or minor rule violation, penalties can be imposed by CME Group under the rules, which include fines, suspension or expulsion.
- 48 The CFTC has no information that would cause it to suspect or conclude that CME Group has not been meeting its obligations to enforce compliance with its operating rules.
- 49 On the basis of information available to us and information provided by CME Group and the CFTC, we are satisfied that CME Group has adequate arrangements for enforcing compliance with its operating rules.

Regulation of CME Group in the United States

- 50 We received information from the CFTC about the regulation of CME Group during the assessment period.
- 51 The CFTC has advised us that:
- CME Group remains a DCM under the CEA in ‘good standing’ with the CFTC and continues to meet its self-regulatory obligations;
 - it is not aware of any information or instances indicating the inadequacy of CME Group’s supervisory arrangements;
 - it has no information that would cause it to suspect or conclude that CME Group is not meeting its continuing obligations under the Corporations Act; and
 - the DMO’s review has not identified any inadequacies in these compliance programs for CME Group and concludes that CME Group has complied with its self-regulatory responsibilities.

Reporting obligations

Annual regulatory report

- 52 We note that CME Group lodged its s792F annual regulatory report with us in a timely manner with the required information.

Reports required by market licence

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

Rule amendments

- 54 CME Group has provided notices on rule changes in a timely manner and with sufficient information to satisfy s793D(3).

Conclusion

- 55 Based on this assessment, we do not have any recommendations to make about CME Group's current supervisory arrangements.

Key terms

Term	Meaning in this document
AFS licence	Australian financial services licence under s911A
ASIC	Australian Securities and Investments Commission
CBOT	Board of Trade of the City of Chicago Inc.
CEA	<i>Commodity Exchange Act</i> (US)
CFTC	Commodity Futures Trading Commission
Ch 7 (for example)	A chapter in the Corporations Act (in this example numbered 7)
CME	Chicago Mercantile Exchange Inc.
CME Group	CBOT and CME
Corporations Act	<i>Corporations Act 2001</i> (Cth)
DCM	A designated contract market
DMO	Division of Market Oversight of the CFTC
DMR	Division of Market Regulation of CME Group
market licence	Australian market licence under s791A
market licensee	Holder of an Australian market licence
s794C (for example)	A section of the Corporations Act (in this example numbered 794C), unless otherwise specified