



ASIC

Australian Securities & Investments Commission

REPORT 209

Market assessment report: London Metal Exchange Limited

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About this report

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

This assessment covers the period 16 April 2009 to 6 April 2010 (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
REP 170	August 2009

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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 a 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 under 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 The assessment covered the period from 16 April 2009 to 6 April 2010.

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 futures contracts in nine metals, including aluminium,

aluminium alloy, copper, zinc, lead, nickel, North American Special Aluminium Alloy Contract (NASAAC), tin and steel. Options contracts are also available for these metals, except for steel. Futures contracts are also offered in two types of plastic: polypropylene and linear low density polyethylene.

- 9 LME introduced futures contracts over cobalt and molybdenum in February 2010. This was a world first, as historically cobalt and molybdenum have traded without the benefits of a regulated exchange.
- 10 An upgrade was made to LME Select in November 2009 to increase functionality, reliability and throughput, and to reduce latency. A new version of LME Select was launched on 16 November 2009. There were no outages during the upgrade of LME Select, and no outages were experienced after the upgrade went live.
- 11 To trade on LME Select it is necessary to be a ring dealing member or an associate broker clearing member of LME. Contracts traded on LME are cleared through LCH.Clearnet Limited. Trading on LME takes place in one of three avenues: by way of open outcry; by the interoffice telephone system; and via LME Select.
- 12 LME's annual trading volume for 2009 was 111.9 million lots traded, down 1% on 2008's 113.2 million total. In LME's latest six-monthly report to ASIC (for the period ended 31 December 2009), the total trading volume from the three Australian market participants on LME Select was 32,599 lots (trading aluminium alloy, copper, nickel, lead, tin and zinc). This accounted for 0.23% of worldwide trading volume, which is a slight fall from the previous six months where trading volumes reached 0.27% of total worldwide volumes.
- 13 LME is authorised and regulated in the United Kingdom by the Financial Services Authority (FSA) as a recognised investment exchange under the *Financial Services and Markets Act 2000* (UK).
- 14 LME is currently also authorised to operate in a number of jurisdictions, including the United States of America, China, Hong Kong, Japan and Singapore.

Regulation of LME in Australia

- 15 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.
- 16 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.

- 17 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.
- 18 LME's market licence is available on the ASIC 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 LME complied with its ongoing supervisory and reporting obligations under its Australian market licence and the Corporations Act.

What we considered

- 22 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;
- information sought from LME for the purpose of this assessment;
- information from the FSA about the market and LME; and
- LME's financial report for the year ended 31 December 2009.

Communication with the foreign regulator

- 23 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.
- 24 ASIC has been advised by the FSA that LME continues to meet the recognition requirements under the *Financial Services and Markets Act 2000* (UK), and therefore remains a recognised investment exchange.

Consultation

- 25 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 has complied with its reporting obligations under the Corporations Act.

Supervisory arrangements

- 26 We conclude that LME has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 27 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 that the arrangements for supervising the market have not changed during the assessment period;
 - the FSA confirmed that LME continues to be recognised as an Investment Exchange in the United Kingdom, 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

- 28 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.
- 29 As a matter of policy, LME's regulation and compliance department does not share information with its commercial and marketing departments. A description of LME's supervisory arrangements for handling conflicts of interest is set out in Section B of our report on our first annual assessment of LME (REP 147), issued in December 2008.
- 30 LME has advised that its conflicts of interest arrangements have not changed since being granted its market licence on 10 April 2007.

Monitoring the market and conduct of participants

- 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. A description of LME's supervisory arrangements for monitoring the conduct of participants on or in relation to the market is set out in Section B of our report on our first annual assessment of LME (REP 147).
- 32 LME advised that no investigations were carried out which involved an Australian participant during the assessment period.
- 33 LME has a committee made up of non-conflicted independent members who have the power to take any action deemed necessary to deal with any market emergency situations that may arise, including in the event of an attempted squeeze of the market.
- 34 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.
- 35 On the basis of 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 members participating in its market.

Enforcing compliance with market operating rules

- 36 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 rule breaches. During the assessment period, LME took disciplinary action in relation to nine breaches of the LME rulebook, none of which involved any of the three Australian participants.

- 37 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.
- 38 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

- 39 We received information from the FSA about the regulation of LME during the assessment period.
- 40 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

- 41 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

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

Rule amendments

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

Conclusion

- 44 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	An Australian financial services licence under s913B of the Corporations Act that authorises a person who carries out a financial services business to provide financial services <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
ASIC	Australian Securities and Investments Commission
Australian market licence	An Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
Ch 7 (for example)	A chapter in the Corporations Act (in this example numbered 7)
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
FSA	Financial Services Authority (UK)
LME	London Metal Exchange Limited
LME Select	LME's electronic trading system
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