



ASIC

Australian Securities & Investments Commission

REPORT 220

Market assessment report

Board of Trade of the City of Chicago Inc.

ARBN 110 594 459

Chicago Mercantile Exchange Inc.

ARBN 103 432 391

October 2010

About this report

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

This assessment covers the period 12 September 2009 to 29 June 2010 (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 CBOT and CME

CBOT and CME were each granted an Australian market licence for an overseas market on 7 December 2005 and 23 December 2003 respectively. The market licence for CME was varied with effect from 31 January 2008. Following the completion of the merger of CBOT and CME, we have issued a joint report for the two entities.

CBOT report number	Report date
REP 92	February 2007
REP 103	February 2008
REP 145	December 2008
CME report number	Report date
REP 52	July 2005
REP 72	May 2006
REP 93	March 2007
REP 102	February 2008
REP 144	December 2008
CME Group Inc. report number	Report date
REP 188	January 2010

Contents

Key findings and recommendations	4
A The assessment.....	5
Purpose and scope	5
Background.....	5
Our methodology	6
B Our observations	8
Supervisory arrangements.....	8
Regulation of CBOT and CME in the United States	11
Reporting obligations	11
Conclusion	12
Key terms	13

Key findings and recommendations

Key findings

- 1 ASIC is satisfied that Board of Trade of the City of Chicago Inc. (CBOT) and Chicago Mercantile Exchange Inc. (CME) 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 CBOT and CME'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 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 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 This report covers the period 12 September 2009 to 29 June 2010.

Background

- 7 CBOT and CME are wholly owned subsidiaries of CME Group Inc. CME Group Inc. comprises four designated contract markets (DCMs). These are CBOT, CME, NYMEX and COMEX. The 2008 CBOT/CME merger

resulted in the establishment of a single Market Regulation Department and a single Audit Department for CBOT and CME.

8 CBOT and CME are each registered to operate in the United States with the Commodity Futures Trading Commission (CFTC) as a DCM under the US *Commodity Exchange Act* (CEA).

9 CBOT and CME are self-regulating bodies governed by their respective certificates of incorporation, by-laws, rules and regulations.

10 Following the CBOT/CME merger, CBOT and CME remain separate self-regulating bodies; however, both sets of rules were harmonised, making the rules parallel in structure, numbering and language where possible.

Regulation of CBOT and CME in Australia

11 CBOT and CME are registered in Australia as foreign companies under the Corporations Act. Their market licences were granted under s795B(2) to operate their overseas financial markets in Australia.

12 The criteria under this section include 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 CBOT and CME are required to comply with their obligations under the Corporations Act and any conditions imposed on their licences, ASIC places a degree of reliance on the regulatory regime imposed by the CFTC.

13 Both CBOT and CME require 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 their markets, unless the participant is exempted under the Australian law from the requirement to hold an AFS licence to participate in the market.

14 Market licences for CBOT and CME are available on our website at www.asic.gov.au/markets.

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, which 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 CBOT and CME complied with their ongoing supervisory and reporting obligations under their respective Australian market licences and the Corporations Act.

What we considered

- 18 In conducting our assessment we considered:
- information we received from and about CBOT and CME in the ordinary course of our dealings with the licensees;
 - CBOT and CME's annual regulatory reports required under s792F;
 - information from the media, CME Group Inc.'s website and other sources;
 - CBOT and CME's six-monthly licence condition reports to ASIC;
 - information sought from CBOT and CME for the purpose of this assessment;
 - information from the CFTC about CBOT and CME; and
 - CME Group Inc.'s financial report for the year ended 31 December 2009.

Communication with the foreign regulator

- 19 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. We have received confirmation from the CFTC that CBOT and CME remain DCMs in 'good standing' with the CFTC.

Consultation

- 20 Our findings are set out in Section B of this report. CBOT and CME have 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 their clarifications.

B Our observations

Key points

We have considered the adequacy of CBOT and CME's arrangements for supervising their markets, including arrangements for:

- handling conflicts between the commercial interests of the licensees and the need for the licensees to ensure that their markets are fair, orderly and transparent;
- monitoring the conduct of participants on or in relation to the markets; and
- enforcing compliance with their markets' operating rules.

CBOT and CME did not make any substantial changes to their supervisory arrangements during the assessment period.

We do not have any recommendations to make about CBOT and CME's current supervisory arrangements.

We also note that CBOT and CME have complied with their reporting obligations under the Corporations Act.

Supervisory arrangements

- 21 We conclude that CBOT and CME have adequate arrangements for the supervision of their markets in accordance with their obligations under s792A(c).
- 22 Our conclusion is based on the following observations drawn from information gathered during the assessment process, our observations from our ongoing correspondence with CBOT and CME, and the present operating conditions (including trading volumes and financial products traded on the markets):
- CBOT and CME confirmed that the arrangements for supervising their markets have not changed during the assessment period;
 - during the assessment period, nothing came to our attention to suggest that CBOT and CME's supervisory arrangements are not operating properly; and
 - the CFTC confirmed that both CBOT and CME remain in good standing as DCMs, and that there was no disciplinary action taken against them.

Managing conflicts of interest

- 23 Core principle 15 of s5(d) of the 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.
- 24 Chapters 2 and 4 of both CBOT and CME's rules provide the arrangements for managing conflicts of interest. Members of the Board of Directors, the Executive Committee, the Market Regulation Oversight Committee and all disciplinary committees must excuse themselves from such bodies' deliberations and voting on any matter in which such a member has a direct and substantial interest in the outcome of the matter.
- 25 The CFTC is not aware of any issues or problems with respect to CBOT and CME's procedures for handling conflicts of interest between their commercial and self-regulatory functions.
- 26 Based on our review of the information on hand and information provided by CBOT, CME and the CFTC, we are satisfied that both CBOT and CME continue to have adequate arrangements for handling conflicts of interest.

Monitoring the market and conduct of participants

- 27 Core principle 2 of s5(d) of the CEA requires CBOT and CME to monitor and enforce compliance with their rules, including terms and conditions of any contracts to be traded and any limitations on access to the contract market.
- 28 Chapter 4 of both CBOT and CME's 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 who violates the rules.
- 29 CBOT and CME, through the Market Regulation Department, conduct contract surveillance, audit trail supervision and trade practice surveillance programs, which are designed to ensure that the markets are fair, orderly and transparent.
- 30 The Audit Department and Risk Management Department conduct financial surveillance and audit programs to monitor the financial condition of member firms, their compliance with financial requirements and reporting, and their ability to comply with their obligations to customers.
- 31 If the surveillance/investigative activities of the Market Regulation Department or Audit Department identify a potential enforcement/disciplinary issue, a report is presented to one of three major disciplinary committees (Probable Cause, Business Conduct or Clearing House Risk), depending on the nature of the alleged violations. The latter two committees may issue sanctions if their findings warrant.

- 32 The CFTC's Division of Market Oversight (DMO) performs regular reviews, called rule enforcement reviews, of each DCM's ongoing compliance with the required core principles. The CFTC recently released its rule enforcement review of CBOT and CME's audit trail, trade practice surveillance and disciplinary programs for the period 1 January 2008 to 1 January 2009.
- 33 DMO found that CBOT and CME maintain adequate audit trail, trade practice and disciplinary programs; however, some recommendations were made. CBOT and CME have confirmed they are evaluating the CFTC's recommendations and will respond to them.
- 34 Additionally, DMO's routine ongoing surveillance of CBOT and CME's market activities and self-regulation of their markets has not identified any inadequacies in the exchanges' market monitoring programs or any evidence to suggest that CBOT or CME have not complied with their self-regulatory responsibilities.
- 35 The CFTC has confirmed it does not have any information that would cause it to suspect or conclude that CBOT and CME do not have adequate arrangements for monitoring their markets or the conduct of participants on their markets.
- 36 On the basis of information available to ASIC and information provided by CBOT, CME and the CFTC, we are satisfied that CBOT and CME have adequate arrangements for monitoring their markets and the conduct of participants.

Enforcing compliance with market operating rules

- 37 Core principle 2 of s5(d) of the CEA requires CBOT and CME to monitor and enforce compliance with their rules, including having arrangements, resources and authority for effective rule enforcement. The CFTC believes that this should include the authority and ability to terminate activities of a member or market participant, as well as the authority and ability to terminate the activities of a member or market participant.
- 38 Chapter 4 of both CBOT and CME's rules provide for the enforcement of trading rules to ensure fair and equitable trading and for having the capacity to detect, investigate and discipline any person who violates the rules. The chapter states the Chief Regulatory Officer has the duty of enforcing the rules, while utilising the resources of the Market Regulation Department and other exchange resources, as required, to conduct investigations of alleged rule violations and market conditions. The Chief Regulatory Officer also has the authority to inspect books and records of all members, and to require any member to appear and answer questions regarding the alleged violations.

This authority may also be delegated to the staff of the Market Regulation Department.

- 39 If the activities of the Market Regulation Department identify a potential enforcement/disciplinary issue, a report is presented to one of three major disciplinary committees (Probable Cause, Business Conduct or Clearing House Risk), depending on the nature of the alleged violations. Prescribed penalties for rule violations include fines, suspension and expulsion.
- 40 CBOT and CME have not taken any disciplinary action against Australian participants during the assessment period.
- 41 The CFTC does not have any information that would cause it to suspect or conclude that CBOT and CME have not been meeting their obligations to enforce compliance with their operating rules.
- 42 On the basis of information available to ASIC and information provided by CBOT, CME and the CFTC, ASIC is satisfied that CBOT and CME have adequate arrangements for enforcing compliance with their operating rules.

Regulation of CBOT and CME in the United States

- 43 We received information from the CFTC about the regulation of CBOT and CME during the assessment period.
- 44 The CFTC confirmed that CBOT and CME remain DCMs under the CEA and in 'good standing' with the CFTC, and continue to meet their self-regulatory obligations.

Reporting obligations

Annual regulatory report

- 45 We note that CBOT and CME have lodged their s792F annual regulatory reports with ASIC in a timely manner with the required information.

Reports required by market licence

- 46 We also note that CBOT and CME have lodged their six-monthly reports with us on time and these contained the information required.

Rule amendments

- 47 CBOT and CME have provided notices on rule changes in a timely manner and with sufficient information to satisfy s793D(3) of the Corporations Act.

Conclusion

48 Based on this assessment, we do not have any recommendations to make about CBOT and CME'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 Note: This is a definition contained in s761A of the Corporations Act.
ASIC	Australian Securities and Investments Commission
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
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	CME Group Inc.
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
DCM	A designated contract market
DMO	Division of Market Oversight of the CFTC
market licensee	Holder of an Australian market licence
rule enforcement review	A regular review of each DCM's compliance with required core principles, performed by DMO
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified