



**ASIC**

Australian Securities & Investments Commission

**REPORT 232**

# **Market assessment report: BGC Partners (Australia) Pty Limited**

**ACN 092 873 099**

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## **About this report**

This report summarises ASIC's fourth 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 2009 to 30 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 BGCA

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

Report number	Date released
REP 183	January 2010
REP 172	September 2009
REP 120	February 2008

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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.

## Recommendations

- 2 ASIC has recommended enhancements and improvements to BGCA's arrangements for supervising the market. These include that BGCA review and make any appropriate changes to its Compliance Manual and monitoring processes to ensure that those who are involved in the supervision of BGCA's market have a clearer understanding of BGCA's obligations. BGCA is in the process of making these changes, as detailed later in this report.
- 3 ASIC has also recommended that BGCA review the human resources that it has allocated to supervising the market, in light of the obligations on holders of an Australian market licence (market licensees) under the Corporations Act, to determine whether additional resources are required. BGCA has agreed to do so, and will be reporting to ASIC in this regard by 30 September 2011.
- 4 BGCA has also agreed to submit to ASIC, on a six-monthly basis, copies of Compliance's monthly reports to management and details of all supervisory issues that have been identified in the relevant six-month period.

## 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 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

- 5 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.
- 6 ASIC is required to assess at least once a year how well a market licensee complies with its obligations in s792A(c): s794C(2).
- 7 This assessment covers the period 1 September 2009 to 30 June 2010.

### Background

- 8 BGCA is a proprietary company wholly owned by BGC Global Holdings LP, a foreign limited partnership.
- 9 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 eSpeed<sup>sm</sup> (rebranded as BGC Trader) electronic trading system. The participants on BGCA's market are professional investors as described in section 7 of BGCA's market licence. As at 31 July 2010, BGCA had 20 participants operating on its market.

- 10 In the over-the-counter financial markets, the total turnover of Australian Government and non-government debt securities for the 2009–10 period was \$928 billion and \$675 billion, respectively.<sup>1</sup>
- 11 On 9 December 2010, the Minister approved a variation to BGCA’s market licence that removed the requirement for Australian participants to be authorised deposit-taking institutions (ADIs). BGCA has amended its operating rules accordingly.
- 12 Prior to the variation being granted, BGCA notified us that an internal review had discovered that one of the Australian participants on its market was not an ADI, as was required by BGCA’s market licence. BGCA subsequently took steps to ensure that the relevant entity would not place any further orders onto the electronic trading platform until it was permitted to do so in accordance with the market licence and operating rules.
- 13 BGCA operates a ‘hybrid’ market model whereby trading is facilitated both on-screen and off-screen via voice broking. On-screen trading occurs when a participant (or BGCA broker on behalf of a participant) directly enters an order into the trading platform. Off-screen (voice-only) trading occurs when a BGCA broker broadcasts an order to all participants as per the normal market convention for over-the-counter voice-brokered trades. Off-screen orders may, on participant instruction, be placed into the electronic market by a BGCA broker to be either worked simultaneously or individually in both markets.
- 14 During the assessment period, in addition to a 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. Our assessment of BGCA does not cover BGCA’s compliance with its AFS licence obligations.
- 15 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](http://www.asic.gov.au/markets).
- 16 In addition to its market licence and AFS licence obligations, BGCA has obligations resulting from its participation in the ASX 24 market (formerly the Sydney Futures Exchange (SFE)). In October 2010, BGCA was the subject of disciplinary action for contravening the then-SFE operating rules in March 2009.<sup>2</sup> Our assessment of BGCA relates only to BGCA’s market licence obligations and not BGCA’s obligations that arise as a result of its participation on the ASX 24 market.
- 17 On 9 December 2010, BGC Brokers LP (BGCB), a member of the BGC Partners Inc group of entities (BGC), obtained an exemption from the

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<sup>1</sup> Australian Financial Markets Association, *2010 Australian Financial Markets Report*.

<sup>2</sup> Australian Securities Exchange, *ASX Circular 373/10*.

requirement to hold a market licence to enable it to operate a financial market in credit derivatives, foreign exchange options and interest rate derivatives. BGCB has appointed BGCA as its local agent in Australia. We understand that BGCA's brokers, Compliance Manager and management will, on behalf of BGCB, perform certain supervisory activities with respect to trading that originates from Australia under the exemption.

## Our methodology

### Our assessment process

- 18 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.
- 19 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

- 20 Our focus in this assessment was to review:
- how well BGCA complied with its ongoing supervisory obligations under its market licence and the Corporations Act during the assessment period; and
  - the adequacy of BGCA's financial, technological and human resources to operate and supervise its market.

### What we considered

- 21 In conducting our assessment of BGCA we considered:
- BGCA's 2009 annual regulatory report, provided by BGCA under s792F of the Corporations Act;
  - a report 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* 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 18 August 2010, where we conducted interviews with BGCA's Compliance Manager, Managing Director and a broker; and
- BGCA's policies and procedures for the conduct of BGCA in general and its supervisory responsibilities in particular.

### **Consultation**

22 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.

Our assessment has produced a number of observations and key findings. BGCA has responded to the assessment in a constructive way by making or planning improvements.

### Supervisory arrangements

- 23 As stated in *Market assessment report: BGC Partners (Australia) Pty Limited* (REP 172), in response to the recommendations we made in *Market assessment report: BGC Partners (Australia) Pty Limited* (REP 120), BGCA conducted a thorough review of its system of supervision. As a result, a number of changes were made, including the transference of the e-Commerce support team'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.
- 24 In our last assessment—*Market assessment report: BGC Partners (Australia) Pty Limited* (REP 183)—based on the information we received from BGCA, it appeared that BGCA's new supervisory procedures were being followed, and we concluded that BGCA had adequate arrangements in place for supervising its market.
- 25 Since this time, and during the assessment period, a restructure of BGCA's management took place:
- BGC's Regional Head of e-Commerce Asia (who was based in Australia) resigned. BGCA's Compliance Manager (previous and current) had previously reported to this person, in addition to the Director of Compliance Europe and Asia (based in London). Based on our past dealings with the Regional Head of e-Commerce Asia, and given that he was not directly involved in BGCA's broking business, we were reasonably confident that he provided good support to the Compliance Manager.

- BGC appointed a new Head of Legal and Compliance Asia (based in Hong Kong). The current Compliance Manager is now reporting directly to the Head of Legal and Compliance Asia, who has taken some of the responsibilities of the Regional Head of e-Commerce Asia.
- The Head of Trading and Desk Head of Interest Rate Swaps has been appointed Managing Director and local director of BGCA, overseeing BGC's business in Australia. The current Compliance Manager reports on an informal basis to the Managing Director.

- 26 In addition to the management changes listed at paragraph 25, there was a change in BGCA's Compliance Manager. BGCA's current Compliance Manager commenced in April 2010. The Compliance Manager he replaced was in the role for 16 months.
- 27 During the assessment, we identified areas of the compliance processes and procedures that would benefit from enhancement or further improvement. We recommended a review of the existing compliance structure to ensure that those who play a role in the supervision of BGCA's market have a clearer understanding of BGCA's responsibilities and obligations.
- 28 In response to our observations and recommendations, BGCA has reviewed and updated its Compliance Manual and its procedures for the Monthly Outlier Report and Monthly Trade Check Reports. BGCA is currently developing an Exception Report which will replace the Monthly Outlier Report. Further details regarding these procedures and reports are outlined at paragraphs 37–39 below.
- 29 At paragraph 12 we stated that it was discovered by BGCA that one of the Australian participants on its market was not an ADI, as was required by BGCA's market licence. As a result of this, BGCA has reviewed and updated its participant on-boarding policy and procedures to minimise future occurrences.
- 30 BGCA has made (and is in the process of making further) changes to its compliance processes and procedures following the observations and recommendations we made during the assessment. Given the number of obligations BGCA now has (as set out at paragraphs 14–17 above), we have also recommended that BGCA conduct a review of the human resources it has allocated to supervising the market in light of the obligations on market licensees under the Corporations Act.
- 31 BGCA's brokers and all relevant staff are required to undertake one hour of training specific to market supervisory issues every year and one hour specific to conflicts of interest every six months. The Compliance Manager keeps a register of all training to ensure the brokers and relevant staff meet their requirements.

32 As detailed above, BGCA is currently making enhancements and improvements to its existing arrangements for supervising its market. We are continuing to work with BGCA on this by reviewing these enhancements and improvements and providing our feedback.

### **Managing conflicts of interest**

33 During our assessment, we reviewed BGCA's system of supervision in which broking and compliance staff are used to monitor BGCA's actions, and the actions of participants, on and in relation to the market 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.

34 BGCA's Conflicts Policy Statement (conflicts policy) is reviewed by the Compliance Manager every six months. This review process is set out at paragraph 25 of REP 183. BGCA informed us that, as a result of its review of the conflicts policy during the assessment period, no changes have been necessary. In our view, the conflicts policy is sufficient to cover BGCA's current business and the process by which BGCA reviews the policy is appropriate.

35 BGCA's 'hybrid' market model allows the BGCA brokers to enter orders on behalf of participants directly into the trading platform, 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. Prior to recent changes (discussed at paragraph 37), BGCA managed potential conflicts of interest by requiring its brokers to maintain detailed trade sheets for all orders they received. Compliance was required to conduct spot checks of these trade sheets and any issues or investigations resulting from the spot checks were required to be reported to management.

36 In our last assessment, we were satisfied that BGCA's process for monitoring orders, as set out in the Compliance Manual, was being followed and was adequate. During this assessment, we reviewed BGCA's brokers' trade sheets, Compliance's Monthly Trade Check Report (which record results of order checks) and Compliance's Monthly Outlier Report (which records findings of the outlier review—discussed at paragraph 41). We identified areas of these processes and procedures that would benefit from enhancement or further improvement.

37 In response to the observations and recommendations we made during the assessment, BGCA has taken a number of steps to enhance and improve its compliance processes and procedures, including reviewing and updating the procedures for the Monthly Trade Check Report and Monthly Outlier Report, discussed in more detail at paragraphs 38–39 and 41. In addition,

BGCA has developed an electronic log to replace the trade sheets that were required to be filled out manually by brokers for all on-screen orders (brokers are still required to maintain trade sheets for all off-screen orders). An electronic log is kept for each order, containing details of the:

- broker's name;
- date;
- order time;
- participant's name;
- instrument;
- order direction;
- price;
- order size;
- counterparty's name; and
- trade time.

We have reviewed this electronic log and are satisfied that it captures all the required information.

- 38 The Compliance Manager is now required to conduct monthly order checks. The Monthly Trade Check Report, compiled at the end of each month, details the findings of 15 randomly selected on-screen orders from the system log and five randomly selected off-screen orders from trade sheets against phone recordings, to ensure end-to-end completeness. If the details on the electronic log and trade sheets deviate from the phone recordings, the Compliance Manager will conduct an investigation and report his findings to the Head of Legal and Compliance Asia and the Director of e-Commerce Asia.
- 39 The Compliance Manual now outlines the process for compiling each report (including the Monthly Trade Check Report). Tables detailing the requirements of each report have been included. Each table briefly describes the report, the frequency of the report, the parties responsible for the report preparation and review, and the mandatory comments/information to be included in the report.
- 40 BGCA has reported that no conflicts of interest have arisen during the assessment period.

### **Monitoring the market and conduct of participants**

- 41 In REP 183 we discussed how BGCA monitors the conduct of participants and the market:
- The operating rules make market participants responsible for the accuracy of details and the integrity and authenticity of all information, bids and offers that are submitted to the market. They are also

responsible for making their own arrangements for the clearing and settling of transactions.

- The Electronic Trading Guidelines, which are incorporated into and form part of BGCA's operating rules, govern trading on the system. Under these guidelines, BGCA may cancel a transaction in certain circumstances.
- BGCA relies on the BGCA brokers and market participants to identify unusual activity or activity likely to mislead/cause market confusion. BGCA brokers are required to monitor and report all breaches and possible breaches of the operating rules by participants, suspected false and misleading conduct, and any other suspected problems or issues that affect the operation of the market.
- BGCA can suspend or terminate a market participant in the event they breach the operating rules. In addition, BGCA also has the right to limit 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 the client agreements that participants are required to enter into.
- The e-Commerce support team maintains an up-to-date list of participants authorised to access the market, and reports monthly to Compliance regarding new admissions and terminations. In response to recommendations made by us, this report has now been revised to include reasons for the new admissions and terminations of participants and participant's traders.
- The Compliance Manager reviews a number of randomly selected orders that were entered into the electronic trading platform by either a BGCA broker or market participant, to identify any changes in order prices outside the allowable limits as outlined in the Electronic Trading Guidelines. A Monthly Outlier Report is prepared by the Compliance Manager and forwarded to the Head of Legal and Compliance Asia as part of Compliance's monthly reporting responsibilities. If the changes in order prices are outside the allowable limits, the Compliance Manager is required to conduct an investigation and report to management. In response to a recommendation made by us, the procedure for the Monthly Outlier Report is now more clearly set out in the Compliance Manual.

42 BGCA is currently developing an Exceptions Report to replace the Monthly Outlier Report. According to BGCA, this Exceptions Report will identify all orders entered into the electronic trading system that have a greater price deviation (from the previous order price) than what is allowed in the Electronic Trading Guidelines. The Compliance Manager will then review all exceptions identified in that report. In the meantime, BGCA will continue

to conduct the outlier checks as per the recently updated procedure set out in the Compliance Manual.

- 43 BGCA reported that no disputes have arisen between participants or between BGCA and participants regarding trading and compliance with the operating rules during the assessment period.

### **Enforcing compliance with the operating rules**

- 44 There were no changes to BGCA's operating rules during the assessment period. However, BGCA recently made operating rule changes in response to the market licence variation. These changes became effective on 10 February 2011.
- 45 All breaches of the operating rules must be reported to the Compliance Manager, who will investigate and report findings, including recommended action. The Head of Legal and Compliance Asia, in consultation with the Director of e-Commerce Asia, is responsible for deciding whether disciplinary action should be taken against the participant. General Counsel Europe and Asia makes the final determination regarding the termination of a participant's participation in the market.
- 46 During our assessment we did not identify any breaches or potential breaches of the operating rules by participants. ASIC is satisfied with BGCA's arrangements to enforce compliance with the operating rules.

## **Resources**

- 47 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.

### **Financial resources**

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

### **Technological resources**

- 49 BGCA's technology has dealt adequately with existing volumes on the market and no market disruptions have occurred. We are satisfied that BGCA has adequate technological resources in order to operate its market.

## Human resources

- 50 During the assessment period, BGCA relied on its brokers, Compliance Manager and management to perform the required supervisory functions for the market. As discussed at paragraphs 25-26, there was a change in Compliance Manager and a restructure in BGCA's management during this time.
- 51 As set out at paragraphs 14–17, BGCA has a number of obligations in addition to the obligations it has as a market licensee. Given this, together with the observations we made during the assessment, we have recommended that BGCA review the human resources that it has allocated to supervising the market, in light of the obligations on market licensees under the Corporations Act, to determine whether additional resources are required.

## Conclusion

- 52 Our recommendations in relation to BGCA's current supervisory arrangements are set out at paragraphs 2–4.

## 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
ASX 24	The market formerly known as the Sydney Futures Exchange (SFE), operated by Australian Securities Exchange Limited
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
BGC	BGC Partners Inc
BGCA	BGC Partners (Australia) Pty Limited
BGCB	BGC Brokers LP
BGC Global Holdings LP	A foreign limited partnership that wholly owns BGCA
Ch 7 (for example)	A chapter in the Corporations Act (in this example numbered 7)
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
electronic log	An electronic log of each order placed by a broker through on-screen trading. It replaces the trading sheet, which used to be filled out manually
market licensee	Holder of an Australian market licence
off-screen trading	Occurs when a BGCA broker broadcasts an order to all participants as per the normal market convention for over-the-counter voice-brokered trades
on-screen trading	Occurs when a participant (or a BGCA broker on behalf of a participant) directly enters an order into the trading platform
trading sheet	A manually completed record of each order placed by a broker through off-screen trading. For on-screen trading, it was replaced by the electronic log
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified
SFE	The market formerly known as the Sydney Futures Exchange (now ASX 24)