



**ASIC**

Australian Securities & Investments Commission

**REPORT 248**

# **Market assessment report: ICE Futures Europe**

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## **About this report**

This report summarises ASIC's first annual assessment of ICE Futures Europe (ICE) under s794C of the *Corporations Act 2001* (Cth) (Corporations Act).

This assessment covers the period 10 February 2010 to 8 February 2011 (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.

### This is the first report on ICE.

ICE was granted an Australian market licence for an overseas market on 10 February 2010.

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# Key findings and recommendations

## Key findings

- 1 ASIC is satisfied that during the assessment period ICE had adequate arrangements for the operation and 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 ICE's arrangements for operation and supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.

## A The assessment

### Key points

ASIC conducts annual assessments of market licensees, such as ICE, 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 On 1 August 2010, ASIC took over responsibility for supervising Australia's domestic licensed markets from market operators. As a consequence, amendments were made to the obligations contained in s792A(c) of the Corporations Act. These amendments apply to both domestic and overseas market operators.
- 4 Before the transfer of supervision, under s792A(c) a market licensee was required to have adequate arrangements for supervising its market, including arrangements for handling conflicts, monitoring the conduct of participants, and enforcing compliance with the market's operating rules.
- 5 Following the transfer of supervision to ASIC, a market licensee is required to have adequate arrangements for operating its market, including arrangements for handling conflicts and monitoring and enforcing compliance with the market's operating rules.
- 6 More broadly, overseas market operators (such as ICE) continue to be subject to the existing supervisory obligations in their home jurisdiction. The home regulator of ICE is the Financial Services Authority (FSA) of the United Kingdom. Further details of the regulation of ICE in the United Kingdom are discussed at paragraphs 13–14 below. Should there be any significant changes to the regulation of ICE in the United Kingdom, ICE is required to notify ASIC under s792B(4).
- 7 ASIC is required to assess how well a market licensee complies with its obligations under s792A(c) at least once a year: s794C(2). 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).
- 8 This report covers the period 10 February 2010 to 8 February 2011.

## Background

- 9 ICE is a London-based, wholly owned subsidiary of IntercontinentalExchange, Inc. (ICE Inc.). ICE Inc. is a US incorporated public company established in 2000, governed by the laws of the State of Delaware, and listed on the New York Stock Exchange. ICE Inc. owns a number of electronic and over-the-counter markets through its subsidiaries.
- 10 ICE operates exclusively as an electronic futures and options exchange and is a leading exchange for crude and refined oil futures contracts, as well as futures based on European emissions, natural gas and coal.
- 11 ICE offers Australian participants direct electronic access to its exchange. Access to the market is by way of membership of ICE or through order-routing arrangements with an ICE member.
- 12 ICE's annual trading volume for 2010 was 201,103,491 contracts.

### Regulation of ICE in the United Kingdom and other jurisdictions

- 13 ICE is supervised and regulated in the United Kingdom by the FSA as a Recognised Investment Exchange (RIE) under the *Financial Services and Markets Act 2000* (UK).
- 14 As an RIE, ICE has regulatory responsibility in its own right. It is required to maintain sufficient financial resources, adequate systems and controls, and effective arrangements for monitoring and disciplining its members.
- 15 ICE is also authorised to operate in a number of jurisdictions, including the United States of America, Singapore, Hong Kong, Dubai and all of the member countries of the European Economic Area.

### Regulation of ICE in Australia

- 16 ICE was registered under Div 2 of Pt 5B.2 of the Corporations Act as a foreign company in Australia on 6 November 2007.
- 17 ICE was granted an Australian market licence in respect of its electronic trading system in Australia under s795B(2) of the Corporations Act on 10 February 2010.
- 18 ICE's Australian market licence requires that all Australian market participants seeking ICE membership must hold, or be exempt from holding, an Australian financial services (AFS) licence that permits trading of products that can be dealt with on the market.
- 19 Australian participants in ICE are not permitted to become clearing members. To allow for clearing and settlement, all Australian participants

must have arrangements in place with an ICE clearing member located outside Australia. Clearing and settlement arrangements for transactions effected through the market must be those provided by ICE Clear Europe Limited.

- 20 A copy of ICE's market licence is available on the ASIC website at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).

## Our methodology

### Our assessment process

- 21 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.
- 22 We therefore use the assessment process to:
- reach conclusions about the adequacy of the arrangements a market licensee has in place in accordance with its obligations under s792A(c) of 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

- 23 Our focus in this assessment was to review how well ICE complied with its ongoing obligations under its Australian market licence and the Corporations Act.

### What we considered

- 24 In conducting our assessment we considered:
- information we received from and about ICE in the ordinary course of our dealings with the licensee;
  - ICE's annual regulatory report required under s792F;
  - information from the media, ICE's website and other sources;
  - ICE's six-monthly licence condition reports to ASIC;
  - information sought from ICE for the purpose of this assessment; and
  - information from the FSA about ICE.

## Communication with the foreign regulator

- 25 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.
- 26 We have received confirmation from the FSA that ICE continues to meet the recognition requirements under the *Financial Services and Markets Act 2000* (UK) and therefore remains an RIE. The FSA has also confirmed that it does not have any concerns about ICE's compliance with its supervisory obligations, and that it did not take any disciplinary action against ICE during the assessment period.

## Consultation

- 27 Our findings are set out in Section B of this report. ICE 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 ICE's clarifications.



## B Our observations

### Key points

We have considered the adequacy of ICE's arrangements for the operation and supervision of its 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.

ICE did not make any substantial changes to its supervisory arrangements during the assessment period.

We do not have any recommendations to make about ICE's arrangements for the operation and supervision of its market.

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

### Supervisory arrangements

- 28 We conclude that during the assessment period ICE had adequate arrangements for the operation and supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.
- 29 Our conclusion is based on the following observations drawn from information gathered during the assessment process, our ongoing correspondence with ICE, and the present operating conditions (including trading volumes and financial products traded on the market):
- ICE confirmed that the arrangements for supervising the market did not substantially change during the assessment period;
  - the FSA confirmed that ICE remains in good standing as an exchange, and that there was no disciplinary action taken during the assessment period against ICE; and
  - during the assessment period, nothing came to our attention to suggest that ICE's supervisory arrangements were not operating properly.

## Managing conflicts of interest

- 30 As an RIE in the United Kingdom ICE is required to manage conflicts of interest fairly, whether it is between ICE and its customers, or between its customers.
- 31 The FSA's Recognised Investment Exchanges and Recognised Clearing Houses sourcebook (REC) states that, in assessing whether the systems and controls used by an RIE in the performance of its functions are adequate and appropriate for the scale and nature of its business, the FSA may have regard to, among other things, the RIE's arrangements for the management of conflicts of interest.
- 32 All ICE personnel, including employees, consultants, directors and officers, are subject to the Code of Business Conduct and Ethics.
- 33 Staff are required to disclose to management any situation that may involve, or appear to involve, a conflict of interest or material interest. In this regard, they are given guidance as to what may amount to a conflict of interest, and how any such conflict should be managed.
- 34 ICE's Compliance section (which is part of ICE's Regulation Department) is separated, by means of an information barrier, from the commercial and administrative operations of ICE.
- 35 Where an ICE member is subject to disciplinary action, any employee of that particular member who sits on the Authorisation, Rules and Conduct Committee of ICE (ARC) must declare their conflict of interest and withdraw from the process.
- 36 ICE submits that, as an RIE, it complies with the FSA's guidance on the management of conflicts of interest set out in REC 2.5.10.
- 37 The FSA has no information that would cause it to suspect or conclude that ICE has not been meeting its arrangements for handling conflicts.
- 38 Section 792A(c)(i) requires an applicant to have adequate arrangements for handling conflicts between the commercial interests of the licensee and the need for the licensee to ensure that the market operates in a fair, orderly and transparent manner.
- 39 On the basis of information available to ASIC and information provided by ICE and the FSA, ASIC is satisfied that during the assessment period ICE had adequate arrangements for handling conflicts of interest.

## Monitoring the market and conduct of participants

- 40 Supervision of ICE's members is conducted by ICE's Market Supervision Department and the Compliance section of ICE's Regulation Department.

- 41 ICE's Market Supervision Department monitors trading on its electronic trading system (ICE Platform) in real-time. It reviews reports on the exposure of ICE members and their clients, conducts trade audits and routine visits to ICE members, and monitors the delivery process of deliverable futures contracts and the settlement of Exchange for Physical/Exchange for Swap (EFP/EFS) and block trades.
- 42 ICE's Compliance section investigates reports of suspected misconduct. In addition, it produces daily reports that analyse possible price spikes, questionable trading or other business conduct practices. The data used to generate these daily reports is sourced from ICE's databases, the trade registration system, ICE members' trading documentation, and audio and telephone records. On detecting evidence of misconduct, Compliance will commence a formal investigation.
- 43 In 2010, ICE deployed two new market oversight tools, SMARTS and ICECap:
- SMARTS is a third-party market monitoring solution that generates real-time alerts of market incidents such as price spikes. It also has a playback facility that enables the replay of market events for post-trade analysis. It is used by both Market Supervision and by Compliance.
  - ICECap is a bespoke compliance-specific application that allows large volumes of trade data to be interrogated at high speed.
- 44 ICE has also increased its compliance staff levels from five to eight. The rise in headcount reflects the increase in the number of contracts ICE offers, and the expanded regulatory requirements in respect of position management and reporting.
- 45 On the basis of information available to ASIC and information provided by ICE and the FSA, ASIC is satisfied that during the assessment period ICE had adequate arrangements for monitoring the market and the conduct of participants.

### **Enforcing compliance with market operating rules**

- 46 ICE's Compliance section is required to submit a report to the ARC if there is evidence that a breach of the operating rules has occurred. In that case, the ARC may authorise the initiation of disciplinary proceedings. Disciplinary action can include:
- a verbal or written reprimand;
  - fines;
  - membership suspension;
  - expulsion from the exchange; or
  - reporting the incident to the FSA.

- 47 ICE has arrangements in place with the FSA to assist in the coordination of enforcement actions between these two parties.
- 48 The FSA has no information that would cause it to suspect or conclude that ICE has not been meeting its obligations to enforce compliance with its operating rules.
- 49 On the basis of information available to ASIC and information provided by ICE and the FSA, ASIC is satisfied that during the assessment period ICE had adequate arrangements for enforcing compliance with its operating rules.

## Regulation of ICE in the United Kingdom

- 50 We received information from the FSA about the regulation of ICE during the assessment period.
- 51 The FSA indicated that ICE continues to satisfy its recognition requirements and advised that it does not have any concerns about ICE's compliance with its supervisory obligations. The FSA also advised it did not take any disciplinary action against ICE during the assessment period.

## Reporting obligations

### Annual regulatory report

- 52 We note that ICE lodged its annual regulatory report (as required under s792F) with ASIC in a timely manner with the required information.

### Reports required by market licence

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

### Rule amendments

- 54 ICE 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 ICE's arrangements for the operation and supervision of its market.

## 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.
ARC	Authorisation, Rules and Conduct Committee of ICE
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
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
EFP/EFS	Exchange for Physical/Exchange for Swap
FSA	Financial Services Authority (UK)
ICE	ICE Futures Europe
market licensee	Holder of an Australian market licence
REC	Recognised Investment Exchanges and Recognised Clearing Houses sourcebook
RIE	Recognised Investment Exchange
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified