



**ASIC**

Australian Securities & Investments Commission

**REPORT 250**

# **Market assessment report: London Metal Exchange Limited**

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## **About this report**

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

This assessment covers the period 7 April 2010 to 1 April 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.

### Previous reports on LME

LME was granted an Australian market licence for an overseas market on 10 April 2007.

| Report number | Report date   |
|---------------|---------------|
| REP 209       | June 2010     |
| REP 170       | August 2009   |
| REP 147       | December 2008 |

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## Key findings and recommendations

### Key findings

- 1 ASIC is satisfied that during the assessment period LME 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 LME's arrangements for the 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 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 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 market 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 LME) continue to be subject to the existing supervisory obligations in their home jurisdiction. The home regulator of LME is the Financial Services Authority (FSA) of the United Kingdom. Further details of the regulation of LME in the United Kingdom are discussed at paragraphs 15–16. Should there be any significant changes to the regulation of LME in the United Kingdom, LME 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 7 April 2010 to 1 April 2011.

## Background

- 9 LME is a wholly owned subsidiary of LME Holdings Limited, a private limited company registered in England and Wales.
- 10 LME is a leading exchange for the trading of non-ferrous metals. LME offers a range of futures and options contracts over non-ferrous and minor metals and steel. Futures contracts over plastics such as polypropylene and linear low-density polyethylene were offered, but these were delisted on 29 April 2011. Trading on LME takes place across three trading venues: by open outcry, by the inter-office telephone system and through LMEselect, LME's electronic trading platform.
- 11 In November 2010, LME launched a joint initiative with LCH.Clearnet (LCH) to offer a matching and clearing service for the over-the-counter (OTC) wholesale London gold market. This post-trade service allows bilateral OTC trades to be captured via LME's trade capture system, LMEsmart, with matched bilateral trades submitted to the LCH for clearing. This allows market participants to benefit from margin offsets with other metal contracts listed on the LME; this will improve collateral management, increase liquidity and lower operational costs.
- 12 Another development that occurred during the assessment period involved a joint venture with the Singapore Exchange (SGX) to launch a new series of tradable metal contracts called LME-SGX Metal Futures on 15 February 2011. These futures are traded and cleared on SGX's platforms, during the Asian trading hours via SGX's network of brokers.
- 13 LME's annual trading volume for 2010 was 120.3 million lots traded, up 8% from 2009 (111.9 million).
- 14 LME plans to launch a new version of LMEselect in the second quarter of 2011, which will involve significant upgrades to the system's capacity and robustness.

### **Regulation of LME in the United Kingdom and other jurisdictions**

- 15 LME is authorised and regulated in the United Kingdom by the FSA as a Recognised Investment Exchange (RIE) under the *Financial Services and Markets Act 2000* (UK).
- 16 As an RIE, LME 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.

- 17 LME is also authorised to operate in a number of other jurisdictions, including the United States, China, Hong Kong, Japan and Singapore.

### **Regulation of LME in Australia**

- 18 LME was registered under Div 2 of Pt 5B.2 of the Corporations Act as a foreign company in Australia on 9 August 2006.
- 19 LME was granted an Australian market licence to operate LMEselect under s795B(2) of the Corporations Act on 10 April 2007.
- 20 LME requires all Australian participants to hold (or to be exempt from holding) an Australian financial services (AFS) licence that permits them to trade in the products that can be dealt with on LME's market.
- 21 A copy of LME'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**

- 22 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.
- 23 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**

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

### **What we considered**

- 25 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 licence condition reports to ASIC;
- information sought from LME for the purpose of this assessment;
- information from the FSA about LME; and
- LME's financial report for the year ended 31 December 2010.

### **Communication with the foreign regulator**

- 26 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.
- 27 We have received confirmation from the FSA that LME continues to meet the recognition requirements under the *Financial Services and Markets Act 2000* (UK) and therefore remains a RIE.

### **Consultation**

- 28 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 have considered the adequacy of LME'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.

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

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

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

### Supervisory arrangements

- 29 We conclude that during the assessment period LME had adequate arrangements for the operation and supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.
- 30 Our conclusion is based on the following observations drawn from information gathered during the assessment process, 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 did not change during the assessment period;
  - the FSA confirmed that LME continues to be a RIE in the United Kingdom, and that there was no disciplinary action taken against LME during the assessment period; and
  - during the assessment period, nothing came to our attention to suggest that LME's supervisory arrangements were not operating properly.

## Managing conflicts of interest

- 31 LME has advised that its arrangements for handling conflicts between the commercial interests of the licensee and the need to ensure that the market operates in a fair, orderly and transparent manner are adequate and have not changed since the grant of its licence on 10 April 2007.
- 32 A description of LME's supervisory arrangements for handling conflicts of interest is set out in Section B of *Market assessment report: London Metal Exchange Limited* (REP 147). Issued in December 2008, this was our first annual assessment of LME.
- 33 On the basis of information available to ASIC and information provided by LME and the FSA, ASIC is satisfied that during the assessment period LME had adequate arrangements for handling conflicts of interest.

## Monitoring the market and conduct of participants

- 34 LME's arrangements for monitoring the conduct of participants on or in relation to the market have not changed since it was granted its licence on 10 April 2007. A description of these arrangements is set out in Section B of REP 147.
- 35 LME advised that no investigations or enforcement actions were undertaken in 2010 that involved the conduct of Australian participants.
- 36 On the basis of information available to ASIC and information provided by LME and the FSA, ASIC is satisfied that during the assessment period LME had adequate arrangements for monitoring the market and the conduct of participants.

## Enforcing compliance with market operating rules

- 37 A description of LME's arrangements for enforcing compliance with market operating rules is set out in Section B of REP 147.
- 38 No event has been brought to ASIC's attention where an Australian participant breached LME's operating rules.
- 39 On the basis of information available to ASIC and information provided by LME and the FSA, ASIC is satisfied that during the assessment period LME had adequate arrangements for enforcing compliance with its operating rules.

## Regulation of LME in the United Kingdom

- 40 We received information from the FSA about the regulation of LME during the assessment period.
- 41 The FSA has confirmed that LME continues to satisfy the provisions as required of a RIE in the United Kingdom. The FSA also advised it did not take any disciplinary action against LME during the assessment period.

## Reporting obligations

### Annual regulatory report

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

### Reports required by market licence

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

### Rule amendments

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

## Conclusion

- 45 Based on this assessment, we do not have any recommendations to make about LME'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<br>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                                                                                                                                        |
| 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)                                                                                                                                                                                                                           |
| LCH                       | LCH.Clearnet                                                                                                                                                                                                                                                |
| LME                       | London Metal Exchange Limited                                                                                                                                                                                                                               |
| LMeselect                 | LME's electronic trading system                                                                                                                                                                                                                             |
| LMESmart                  | LME's trade capture system                                                                                                                                                                                                                                  |
| market licensee           | Holder of an Australian market licence                                                                                                                                                                                                                      |
| Pt 5B.2 (for example)     | A part of the Corporations Act (in this example, numbered 5B.2)                                                                                                                                                                                             |
| s794C (for example)       | A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified                                                                                                                                                              |