



ASIC

Australian Securities & Investments Commission

REPORT 295

Market assessment report: BGC Partners (Australia) Pty Limited

ACN 092 873 099

July 2012

About this report

This assessment covers the period 1 July 2010 to 30 June 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 BGCA

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

Report number	Date released
REP 232	March 2011
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 during the assessment period BGC Partners (Australia) Pty Limited (BGCA) had:
 - adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the *Corporations Act 2001* (Corporations Act); and
 - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.

Recommendations

- 2 In view of the factors set out in paragraph 43, we have recommended that BGCA:
 - review, on a quarterly basis, the human resources allocated to supervising the market (in light of the obligations on market licensees, under the Corporations Act, to determine whether additional resources are required); and
 - report the results of each quarterly review to ASIC.
- 3 BGCA has agreed to do so, and will report the findings of its human resources review to ASIC in March, June, September and December of each year.

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 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.

Scope

- 4 On 1 August 2010, the responsibility for supervising Australia's domestic licensed markets was transferred from the majority of domestic market licensees to ASIC. For these operators, the obligations under the Corporations Act to supervise their market were amended in recognition of this new arrangement.
- 5 The Corporations Act was also specifically amended to exclude a small number of licensed domestic market operators, including BGCA, from this transfer. BGCA and three other operators were excluded on the basis that they have certain distinguishing features. These include the requirement that only professional entities may be users of the market and that they may typically use the market for trading only over-the-counter type products. These are also requirements of ASIC's exempt professional markets policy, by which ASIC may consider recommending an exemption from the requirement to hold an Australian market licence.
- 6 As a result, BGCA's supervisory obligations under the Corporations Act are unchanged and continue to require it to have adequate arrangements for supervising the market, including arrangements for:
 - handling conflicts between its commercial interests and its 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.
- 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 keeping with usual practice, we extended the scope of the assessment to include a review

of whether BGCA had sufficient financial, technological and human resources to comply with its obligations under s792A(d).

8 This report covers the period 1 July 2010 to 30 June 2011.

Approach to assessment

9 ASIC's current strategic framework focuses on three key priorities or outcomes. These are:

- confident and informed investors and financial consumers;
- fair and efficient financial markets; and
- efficient registration and licensing.

10 The first two of these are particularly important for licensed markets. In the context of BGCA's market, it is important to note that no retail investors are permitted to directly or indirectly use the market. ASIC considers that markets that limit participation to professional entities are those in which users are typically already confident and informed. In these circumstances, for the market to be fair and efficient a primary focus is on the reliability of the market's operation and the extent to which it meets the legitimate expectations of its users.

11 For that reason, our assessment of these types of professional markets focuses on a narrower subset of the key measures than we might otherwise use if the market permitted retail investors. To determine whether BGCA has complied with its obligations to have adequate supervisory arrangements and adequate resourcing, we focus on:

- whether there have been any changes during the assessment period to the way BGCA supervises its market;
- the nature of any complaints made by market users to BGCA or ASIC about the market's operations and/or BGCA's supervisory activities;
- the occurrence of any technological outages of BGCA's market or concerns about BGCA's technological resources;
- any material changes in human resources dedicated to the operation and supervision of the market which have given rise to concerns or complaints about supervision and/or conflict handling;
- the maintenance of information and data records to support the monitoring of broker and participant conduct on or in relation to the market, including monitoring order information and transactions effected through the market (such as date, time, volume, price and parties); and
- whether BGCA has adequate financial resources to continue to operate its financial market.

Background

- 12 BGCA is a proprietary company wholly owned by BGC Global Holdings LP (BGC Global), a foreign limited partnership. BGC Global is a member of the BGC Partners Inc group of entities (BGC).
- 13 BGCA was granted an Australian market licence on 27 September 2006. We have conducted four assessments of BGCA since its licence was granted. BGCA is licensed to operate a market trading in Australian Government bonds, semi-government bonds, corporate bonds and debentures, and New Zealand Government bonds using the eSpeedsm (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 30 July 2011, BGCA had 23 participants operating on its market.
- 14 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. On 10 February 2011 BGCA amended its operating rules consistent with that variation.
- 15 During the assessment period BGCA introduced an 'auction' functionality on the trading platform. At set times each day, and based on client demand, a BGCA broker may display a financial instrument at a specific price so participants can enter bid or offer sizes during the auction session. At the end of the auction, executed trade details and counterparty names are disclosed to both parties for counterparty approval.
- 16 During the assessment period, in addition to a market licence, BGCA held an Australian financial services (AFS) licence authorising it to carry out 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. However, we note that ASIC has not been notified of any breaches to BGCA's AFS licence obligations during the assessment period.
- 17 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.
- 18 In addition to its market licence and AFS licence obligations, BGCA has obligations resulting from its participation in the ASX 24 market. Our assessment of BGCA relates only to BGCA's market licence obligations and not BGCA's obligations relevant to its participation on the ASX 24 market.
- 19 BGC Brokers LP (BGCB), another member of BGC, is an inter-dealer broker operating from the United Kingdom. On 9 December 2010, BGCB obtained an exemption from the requirement to hold a market licence to permit it to operate an electronic trading platform for credit derivatives, foreign exchange options and interest rate derivatives in Australia. Prior to

this, BGCB obtained relief from the requirement to hold an AFS licence pursuant to Class Order [CO 03/1099] *UK FSA regulated financial service providers*, for UK-regulated wholesale financial service providers. BGCB's market licence exemption is conditional on BGCB being entitled to rely on that class order relief.

- 20 Recently, we became aware that BGCB had failed to comply with a biannual reporting condition of [CO 03/1099]. As a result of this, we notified BGCB that the class order could no longer be relied on. We have since granted BGCB individual AFS licensing relief (ASIC Instrument [12-0712]), which permits BGCB to provide financial services in Australia under similar terms and conditions as outlined in [CO 03/1099].

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. We therefore use the assessment process to:
- reach conclusions about the adequacy of the arrangements a market licensee (such as BGCA) had 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.

Materials we reviewed

- 22 In conducting our assessment we considered:
- BGCA's annual regulatory report for the period 1 January 2010 to 31 December 2010;
 - BGCA's audited financial accounts for the year ended 31 December 2010;
 - information we received from and about BGCA in the ordinary course of our dealings with BGCA as a market licensee (e.g. when processing BGCA's licence variation and operating rule changes referred to in paragraph 14);
 - 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; and

- information we received during our visit to BGCA's office on 6 September 2011, where we conducted interviews with BGC's Head of Legal and Compliance Asia, BGCA's Compliance Manager and BGCA's Managing Director.

Consultation

23 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 have considered the adequacy of BGCA's arrangements and resources for supervising its market, including arrangements for:

- handling conflicts between its commercial interests and its 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.

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

We do not have any recommendations to make about BGCA's supervisory arrangements or resources.

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

Supervisory arrangements

- 24 We conclude that during the assessment period BGCA had:
- adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act, including adequate arrangements for:
 - handling conflicts between its commercial interests and its 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, and
 - sufficient resources to operate its market properly and for the required supervisory arrangements to be provided under s792A(d) of the Corporations Act.
- 25 This conclusion is based on our review of the measures that typically guide our assessment of BGCA and like markets, being:
- there were no material changes to the way in which BGCA supervised its market;
 - there were no complaints made by market users to BGCA or ASIC about the market's operations or BGCA's supervisory activities;

- there were no technological outages of BGCA's market or concerns about BGCA's technological resources;
- there were no material changes in human resources dedicated to the operation and supervision of the market during the assessment period which gave rise to concerns or complaints about supervision and/or conflict handling;
- BGCA maintains information and data records to support the monitoring of broker and participant conduct on or in relation to the market; and
- BGCA's annual audited accounts indicate it has adequate financial resources to continue to operate its financial market.

Supervisory function

- 26 BGCA's supervisory work is primarily undertaken by BGCA's brokers, Compliance Manager and management as described in Section B of Report 232 *Market assessment report: BGC Partners (Australia) Pty Limited* (REP 232), published March 2011. These arrangements did not change materially during the assessment period.

Managing conflicts of interest

- 27 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.
- 28 We have concluded that BGCA had adequate arrangements for managing its conflicts of interest. A description of BGCA's arrangements for handling conflicts of interest is set out in Section B of REP 232.
- 29 Given the introduction of the auction functionality described at paragraph 15, the Compliance Manager conducts checks of emails and telephone logs 15 minutes prior to any auction session to ensure that prices are not disclosed to participants prior to the commencement of the auction. The results of the order checks are recorded in Compliance's Monthly Trade Check Report.
- 30 BGCA has reported that no conflicts of interest were identified during the assessment period. We note that BGCA did not make any material changes to its conflict handling arrangements during the assessment period. There were also no complaints made about BGCA's conflict handling during the assessment period.

Supervising the market and conduct of participants

- 31 BGCA is also required to monitor the conduct of participants in relation to its market. As at 30 July 2011, BGCA had 23 participants operating on its market.
- 32 In REP 232 we discussed how BGCA monitors the market and conduct of participants. During the assessment period, BGCA's monitoring arrangements were enhanced through the development of an Exceptions Report (produced by the trading system) to replace the Monthly Outlier Report (previously prepared manually by the Compliance Manager). This Exceptions Report identifies 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 then reviews all exceptions identified in that report. If the changes in order prices are outside the allowable limits, the Compliance Manager must conduct an investigation and escalate his findings (BGCA is currently reviewing the allowable limits and will update the system and its processes and procedures if necessary).
- 33 BGCA reported that no investigations were required to be carried out during the assessment period. Further, no disputes arose between participants or between BGCA and participants regarding trading and compliance with the operating rules during the assessment period.

Enforcing compliance with market operating rules

- 34 As discussed at paragraph 14, on 10 February 2011 BGCA made operating rule changes consistent with a licence variation that was granted on 9 December 2010.
- 35 BGCA has confirmed that during the assessment period it did not identify any potential breaches of its operating rules requiring investigation and/or enforcement. In addition, there were no complaints made to BGCA or to ASIC about the conduct of participants on BGCA's market.

Resources

- 36 We are satisfied that during the assessment period BGCA had sufficient financial, technological and human resources for the required supervisory arrangements to be provided.

Financial resources

- 37 We have reviewed BGCA's financial position and are satisfied that during the assessment period BGCA had adequate financial resources in order to

operate its market. On 25 March 2011 BGCA's parent entity, BGC Global, confirmed that it will provide BGCA with financial support to enable it to meet its financial obligations over the following 12 months.

Technological resources

38 During the assessment period, no major system outages were reported and there were no complaints received from participants.

Human resources

39 During the assessment period, BGCA relied on its brokers, Compliance Manager and management to perform the required supervisory functions for the market. We are satisfied that this resourcing was adequate.

40 BGCA is BGCB's local agent in Australia. BGCA's brokers, Compliance Manager and management, on behalf of BGCB, perform certain supervisory activities for trading that originates from Australia under the market licence exemption.

41 There have been some significant changes to the human resources allocated to supervision of BGCA's market since the assessment period:

- BGCA's Compliance Manager left BGCA in mid November 2011. His replacement commenced in December 2011 and we met with him in January 2012. BGC's Head of Legal and Compliance Asia was responsible for BGCA's compliance duties prior to the replacement's commencement.
- BGC's Head of Legal and Compliance Asia left BGC in December 2011. BGC is in the process of recruiting a replacement for this role, and in the meantime, all supervisory and disciplinary related matters will be reported to BGC's General Counsel Europe and Asia.
- An additional staff member has been allocated to assist the Compliance Manager.
- BGCA's Managing Director has relocated to the United Kingdom. He has been replaced by BGCA's Executive Managing Director Asia Pacific, who is located in Sydney.
- In accordance with a recommendation we made during the last assessment, BGC conducted a review of the resources it had allocated to supervising the market operated by BGCA to determine whether additional resources were required. As a result of that review, BGC recruited a compliance officer in BGC's Singapore office who will, if required, provide secondary coverage and support for BGCA.

- 42 Given these significant changes, in our next assessment we will review:
- the adequacy of the hand-over process to the new Compliance Manager and whether this new person is performing the supervisory functions required of the role;
 - the duties carried out by the additional compliance staff member and the extent to which he is assisting the Compliance Manager with his supervisory responsibilities;
 - whether the person who fills the role of Head of Legal and Compliance Asia is performing the supervisory functions required of that role (we intend to speak with this person once they have commenced at BGC); and
 - whether the changes in human resources dedicated to the operation and supervision of the market (as described above) have given rise to concerns or complaints about supervision and/or conflict handling.

Conclusion

- 43 During the assessment period there were significant changes to the human resources allocated to the supervision of BGCA's market. We are also conscious of the number of obligations BGCA has (as an AFS licensee, an ASX 24 participant and as BGCB's local agent) and the fact that BGCB failed to comply with a reporting requirement of [CO 03/1099]: see paragraph 20.
- 44 In light of the factors set out in paragraph 43, we have recommended that BGCA initiate a quarterly review of the human resources allocated to supervising the market, in light of its obligations under the Corporations Act to determine whether additional resources are required. We have also recommended that BGCA report the results of each quarterly review to ASIC. BGCA has agreed to do so, and will report the findings of its human resources review to ASIC in March, June, September and December of each year.

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 exchange market formerly known as 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	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
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