



**ASIC**

Australian Securities & Investments Commission

## REPORT 253

# Market assessment report:

**Board of Trade of the City of Chicago Inc.**

**ARBN 110 594 459**

**Chicago Mercantile Exchange Inc.**

**ARBN 103 432 391**

September 2011

### **About this report**

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

This assessment covers the period 30 June 2010 to 22 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 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 CBOT was varied with effect from 17 December 2009. The market licence for CME was varied with effect from 31 January 2008. After the merger of CBOT and CME, we issued a joint report for the two entities.

CBOT/CME joint reports	Report date
REP 220	October 2010
REP 188	January 2010
CBOT reports	Report date
REP 145	December 2008
REP 103	February 2008
REP 92	February 2007
CME reports	Report date
REP 144	December 2008
REP 102	February 2008
REP 93	March 2007
REP 52	July 2005
REP 72	May 2006

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# Key findings and recommendations

## Key findings

- 1 ASIC is satisfied that during the assessment period CBOT and CME had adequate arrangements for the operation and 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 arrangements for the operation and supervision of their markets in accordance with their obligations under s792A(c) of the Corporations Act.

## 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 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 CBOT and CME) continue to be subject to the existing supervisory obligations in their home jurisdiction. The home regulator of CBOT and CME is the Commodity Futures Trading Commission (CFTC) in the United States. Further details of the regulation of CBOT and CME in the United States are discussed at paragraphs 10–12. Should there be any significant changes to the regulation of CBOT and CME in the United States, CBOT and CME 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 30 June 2010 to 22 June 2011.

## Background

- 9           CBOT and CME are wholly owned subsidiaries of CME Group Inc. (CME Group). CME Group comprises four designated contract markets. These are CBOT, CME, Commodity Exchange, Inc. (COMEX) and New York Mercantile Exchange, Inc. (NYMEX). The 2008 CBOT/CME merger resulted in the establishment of a single market regulation department and a single audit department for CBOT and CME.

### Regulation of CBOT and CME in the United States

- 10           CBOT and CME are each registered with the CFTC to operate in the United States as a designated contract market under the *Commodity Exchange Act 1936* (US) (Commodity Exchange Act).
- 11           CBOT and CME are self-regulating bodies governed by their respective certificates of incorporation, by-laws, rules and regulations.
- 12           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

- 13           CBOT and CME were registered under Div 2 of Pt 5B.2 of the Corporations Act as foreign companies in Australia on 19 August 2004 and 23 January 2003 respectively.
- 14           CBOT and CME were each granted an Australian market licence in respect of their electronic trading platforms under s795B(2) of the Corporations Act on 7 December 2005 and 23 December 2003 respectively. The market licence for CBOT was varied with effect from 17 December 2009. The market licence for CME was varied with effect from 31 January 2008.
- 15           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.
- 16           Details of market licences for CBOT and CME are available on ASIC's website at [www.asic.gov.au/markets](http://www.asic.gov.au/markets).

## Our methodology

### Our assessment process

- 17 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.
- 18 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 s729A(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

- 19 Our focus in this assessment was to review how well CBOT and CME complied with their ongoing obligations under their Australian market licences and the Corporations Act.

### What we considered

- 20 In conducting our assessment, we considered:
- information we received from and about CBOT and CME in the ordinary course of our dealings with CBOT and CME;
  - CBOT and CME's annual regulatory reports required under s792F;
  - information from the media, CBOT and CME's websites 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's financial report for the year ended 31 December 2010.

### Communication with the foreign regulator

- 21 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.

- 22 We have received confirmation from the CFTC that CBOT and CME remain designated contract markets in 'good standing' with the CFTC.

## **Consultation**

- 23            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 CBOT and CME's clarifications.



## B Our observations

### Key points

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

- handling conflicts between their commercial interests and their need to ensure that the 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 arrangements for the operation and supervision of their markets.

We also note that CBOT and CME have complied with their reporting obligations under Ch 7.

### Supervisory arrangements

- 24 We conclude that during the assessment period CBOT and CME had adequate arrangements for the operation and supervision of their markets in accordance with their obligations under s792A(c) of the Corporations Act.
- 25 Our conclusion is based on the following observations drawn from information gathered during the assessment process, 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 the markets did not change during the assessment period.
  - CFTC confirmed that CBOT and CME remain in good standing as designated contract markets, and that there was no disciplinary action taken against CBOT and CME 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.

## Managing conflicts of interest

- 26 A description of CBOT and CME's supervisory arrangements for handling conflicts of interest is set out in Section B of *Market assessment report: Board of Trade of the City of Chicago Inc. and Chicago Mercantile Exchange Inc.* (REP 220) at [www.asic.gov.au/reports](http://www.asic.gov.au/reports).
- 27 The CFTC is not aware of any issues or problems with CBOT and CME's procedures for handling conflicts of interest between their commercial and self-regulatory functions.
- 28 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

- 29 A description of CBOT and CME's arrangements for monitoring the conduct of participants on or in relation to the markets is set out in Section B of REP 220.
- 30 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.
- 31 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

- 32 A description of CBOT and CME's arrangements for enforcing compliance with the markets' operating rules is set out in Section B of REP 220.
- 33 CBOT and CME have not taken any disciplinary action against Australian participants during the assessment period.
- 34 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.
- 35 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 enforcing compliance with their operating rules.

## Regulation of CBOT and CME in the United States

- 36 We received information from the CFTC about the regulation of CBOT and CME during the assessment period.
- 37 The CFTC confirmed that CBOT and CME remain designated contract markets under the Commodity Exchange Act and in ‘good standing’ with the CFTC, and continue to meet their self-regulatory obligations.

## Reporting obligations

### Annual regulatory report

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

### Reports required by market licence

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

### Rule amendments

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

## Conclusion

- 41 Based on this assessment, we do not have any recommendations to make about CBOT and CME’s arrangements for the operation and supervision of their markets.

## 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	An 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.
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.
Commodity Exchange Act	<i>Commodity Exchange Act 1936</i> (US)
Corporations Act	<i>Corporations Act 2001</i> (Cth), including regulations made for the purposes of that Act
market licensee	Holder of an Australian market licence
REP 220 (for example)	An ASIC report (in this example, numbered 220)
s794C (for example)	A section of the Corporations Act (in this example, numbered 794C), unless otherwise specified