



**ASIC**

Australian Securities & Investments Commission

**REPORT 120**

**Market assessment report:  
BGC Partners Australia Pty Limited  
ACN 092 873 099**

February 2008

**About this report**

This report summarises ASIC's first annual assessment of BGC Partners Australia Pty Limited (BGCA) under s794C of the *Corporations Act 2001* (Corporations Act).

### 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.

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## Key findings and recommendations

### Key findings

- 1 We are 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 improvements to BGCA's arrangements for supervising and handling conflicts of interest in its market, in particular in relation to the functions of its brokers, helpdesk and compliance officer. In making these recommendations, we have considered the nature of the BGCA market and the length of time the market has been operating.
- 3 Our recommendations are that:
  - BGCA reviews its written procedures, guidelines and education program for supervising its market to ensure they are up-to-date and relevant. One of the key outcomes of the review should be that the supervisory roles of each relevant business unit are clearly defined, with no ambiguity;
  - BGCA makes relevant changes to its written procedures, guidelines and education program for conflicts of interest, particularly relating to the activity of its brokers.

## A The assessment

### Key points

ASIC conducts annual assessments of market licensees, 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 Chapter 7 obligations too.

ASIC uses the licensee's self-assessment reports, information from previous assessments if applicable, 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

- 4 ASIC is required to assess how well a market licensee complies with its obligations in s794A(c) at least once a year: s792C(2).
- 5 A market licensee is required to have adequate arrangements for supervising the market (under s792A) 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 In addition, we are permitted to extend the scope of our assessment to review how well BGCA complies with any or all of its obligations under Chapter 7: s794C(1).

### Background

- 7 BGCA is a proprietary company. It is currently wholly owned by Cantor Fitzgerald L.P. (Cantor Fitzgerald). Cantor Fitzgerald is a Delaware limited partnership, whose general partner is CF Group Management, Inc.
- 8 BGCA was granted an Australian market licence (AML) 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> electronic trading system. The participants on the BGCA market are professional investors as described in Section 7 of BGCA's market licence.

- 9 During the assessment period, in addition to an AML, BGCA held an Australian financial services licence (AFSL) authorising it to carry on a financial services business to wholesale clients for certain financial products. This assessment of BGCA does not cover BGCA's compliance with its AFSL obligations. A copy of BGCA's market licence and the terms of its AFSL are available on ASIC's website at <http://www.asic.gov.au>.

## Our methodology

### Our assessment process

- 10 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.
- 11 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 considered

- 12 In conducting our assessment of BGCA we considered:
- the first annual regulatory report provided by BGCA to ASIC as required under s792F of the Corporations Act;
  - other reports for the periods 27 September 2006 through to 31 December 2006 and 1 January 2007 to 30 June 2007 provided by BGCA to ASIC as required under 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 Investment Commission Act 2001* (Cth) to obtain information about how BGCA is meeting certain obligations under the Corporations Act;
  - information we received during our visit to BGCA's office between 1 August 2007 and 7 August 2007, where we conducted interviews with

BGCA's compliance manager, head of E-Commerce Asia, the Sydney Helpdesk staff member and two brokers; and

- information we received during a demonstration of the market in action at BGCA's office.

### **Consultation**

- 13 BGCA has had the opportunity to review and comment on our findings and recommendations in a draft version of this report. Where appropriate, this final report reflects BGCA's responses.

### **What we focused on for this assessment**

- 14 As this was our first assessment of BGCA, we were primarily interested in:
- understanding how BGCA operates its market and carries out its supervisory functions on a day-to-day basis including in particular, its arrangements in relation to conflicts of interest;
  - how BGCA's actual operations compare with the information supplied in its AML application;
  - the procedures BGCA has put in place for its supervisory functions; and
  - whether BGCA has sufficient technological, financial and human resources to comply with its obligations under s792A(d).

## B Our observations and recommendations for BGCA

### Key points

As part of this assessment, ASIC has considered the adequacy of BGCA's arrangements for supervising its market, including arrangements for:

- handling conflicts between the commercial interests of the market licensee and the need for the market 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.

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

### BGCA is meeting its obligations

- 15 After conducting our assessment, ASIC is satisfied that BGCA has adequate resources for the supervision of its market in accordance with its obligations under s792A(c) of the Corporations Act.
- 16 Our conclusion is based on:
- observations drawn from information gathered during the formal part of the assessment process (see paragraph 24); and
  - the present operating conditions (including trading volumes and financial products traded on the market).
- 17 We note, however, that the BGCA market has been operating for only 12 months and the evolution of the market has required some revision of procedures, current documentation and standardisation of the current reporting mechanism. BGCA is currently putting revised procedures and documentation in place for review by ASIC.

### Supervision of the BGCA market

- 18 During our assessment, we reviewed BGCA's multi-tiered system of supervision in which broking, helpdesk and compliance staff are used to fulfil its licence obligations for ongoing compliance monitoring and supervision of its market.



- 19 As part of this review, we also looked at BGCA's policies, procedures and resources relating to its ongoing licence obligations to monitor and supervise its market.

### **Brokers**

- 20 In its AML application and in material produced under our s30 notice, BGCA submitted that the brokers are the first line of supervision for the market, and that they are required to monitor and report any problems, breaches, possible breaches, conflicts, malfunctions and suspected false or misleading conduct.

### **Helpdesk**

- 21 In its AML application, BGCA submitted that the helpdesk would be responsible for helping supervise the market in accordance with the market operating rules. The application stated that the technology available would allow the helpdesk to investigate data down to the last keystroke. The material produced under our s30 notice also suggested that the helpdesk was the second line of supervision after the brokers.

### **Compliance officer**

- 22 In its AML application, BGCA submitted that the compliance officer would be responsible for internal training and supervision of all staff entering trades through the market, including but not limited to ensuring compliance by its participants.
- 23 BGCA's annual regulatory report indicates that the compliance officer is the third level of supervision, overseeing the general operation of the market and investigating all issues brought forward for review by BGCA brokers, helpdesk staff and BGCA participants. It was also stated that the compliance officer is responsible for the ongoing review of trading and market operations, and investigating possible breaches of the market rules if and when they occur.

### **Observations from our assessment**

- 24 Based on material we reviewed and interviews conducted during our assessment of BGCA, we make the following observations about supervision of the market:
- It is evident that BGCA brokers are aware of their supervisory responsibilities as the first line of supervision for the market, and they appear to be performing this role in tandem with their broking role.

- In relation to the helpdesk and the compliance officer, there appears to be some confusion about who is specifically responsible for matters such as ongoing review of trading, market operations and investigations. As a result of this confusion, certain tasks may not have been adequately performed at times by either the helpdesk or the compliance officer. In ASIC's view, the helpdesk currently appears to be purely a technical support desk.
- There appears to be no established formal procedures or processes to help the responsible supervisory business units deal with (or escalate) regulatory issues if and when they are detected.
- There appears to be no formal or written training programs for the supervisory units about their supervisory responsibilities.
- The helpdesk currently holds a list of clients and their authorised personnel who have access to the trading platform. However, there appears to be no protocol in place to regularly check the participants' and their traders' ongoing authorisation to access the trading platform.

#### Recommendation 1

ASIC recommends that BGCA review its written procedures, guidelines and education program for supervising its market to ensure they are up-to-date and relevant. One of the key outcomes of the review should be that the supervisory roles of each relevant business unit are clearly defined, with no ambiguity.

- 25 BGCA has accepted ASIC's findings and submits that it has already started investigating these issues and implementing procedures to comply with ASIC's recommendations.
- 26 BGCA has informed ASIC that it is currently reviewing the function and responsibilities of its helpdesk and compliance business units. BGCA advised that under its AML submission, it was envisaged that the helpdesk would take an active role in monitoring compliance in the market. The evolution of the market has seen the helpdesk unable to adequately perform this function as envisaged. BGCA submits that it is currently developing more robust monitoring procedures that include moving the supervision and monitoring function from the helpdesk to the compliance officer. BGCA is putting revised procedures in place and is currently documenting these for review by ASIC.
- 27 BGCA is also developing a standardised mandatory training regime for all front office, helpdesk and relevant market staff. BGCA submits that this training will take place quarterly to ensure each broker, broking desk and helpdesk staff member fully understands and maintains their individual responsibilities.

## Conflicts of interest

- 28 During our assessment, we reviewed BGCA's multi-tiered system of supervision in which broking, helpdesk and compliance staff are used to monitor its actions on and in relation to the market, and the actions of participants, to ensure that conflicts of interest are avoided or resolved if they are discovered.
- 29 To better understand BGCA's ability to meet its obligations in this area, we also reviewed the policies, procedures and resources that allow BGCA to effectively meet and monitor its ongoing licence obligations in relation to conflicts of interest.
- 30 BGCA submitted in its AML application that:
- its conflicts policy must ensure that BGCA has adequate arrangements for the management of conflicts between its own interest and those of its clients and that all directors, responsible officers, representatives and key employees of BGCA must be familiar with and follow the policies and procedures set out in the policy statement;
  - the compliance officer will conduct a six-monthly survey with representatives of BGCA to consider possible additional conflicts encountered throughout the preceding six-month period, the effectiveness of existing implementation arrangements, review any complaints received and recorded for issues raising new or existing conflicts;
  - the compliance officer will be responsible for reviewing compliance with BGCA's first-in, first-out (FIFO) order entry policy by way of spot checks of trading by representatives and following up complaints received concerning the conduct of a representative; and
  - the local compliance officer will be responsible for maintaining a file containing the result of spot checks.

## Observations from our assessment

- 31 BGCA currently operates a 'hybrid' market model. This allows BGCA brokers to enter trades on behalf of clients directly into the market, while operating a traditional over-the-counter (OTC) voice broking business. It should be noted that some of the broker's clients might also be participants on the market.
- 32 Although we found no evidence of any inappropriate distribution of information, the fact that the businesses operate side-by-side raises an obvious possibility of a conflict of interest. For example, it is possible that a broker may withhold a client order from the market for the benefit of another client. We further observed that there appears to be little separation of the sales role and supervisory functions for the broking staff.

- 33 The basis for trading on the BGCA trading platform is the first-in, first-out (FIFO) trading principle (i.e. orders will be executed based on best price and first in queue of best price). We note, however, that there was no evidence of any monitoring of the FIFO policy by the compliance officer or the helpdesk.

#### Recommendation 2

ASIC recommends that BGCA makes relevant changes to its written procedures, guidelines and education program for conflicts of interest, particularly relating to the activity of its brokers.

- 34 BGCA submits that while it feels that there is a certain level of 'self regulation' involved in the activities of its brokers, it acknowledges that this issue needs to be addressed to maintain a fair, orderly and transparent market. As such, BGCA is implementing new procedures for brokers for orders received for entry into the market. The procedures will include reinforced training that all orders must be immediately entered into the trading platform, where possible. Brokers will also be required to maintain detailed trade order sheets for all electronic market orders they receive.
- 35 BGCA has advised that the trade order sheets are currently being trialled by its brokers. The introduction of trade order sheets will allow the compliance officer to randomly review a number of orders received by the brokers and compare the order receipt details and times with the times recorded on the market audit log system and other such tools available.

## Enforcing compliance with the markets operating rules

- 36 BGCA has adequate arrangements for enforcing compliance with its operating rules.

## Resources

### Technological

- 37 BGCA has adequate technological resources. The current technology has coped with existing volumes on the market and no serious market disruptions have occurred.

### **Financial**

- 38 BGCA has access to adequate financial resources to continue to operate the market.

### **Human**

- 39 BGCA has sufficient staff employed in various capacities for commercial, supervisory and technological functions. We note that the helpdesk staff was reduced from two people to one person. This does not appear to have affected the operation of the market.

## Key terms

| Term                         | Meaning in this document  |
|------------------------------|---|
| AFSL                         | An Australian financial services licence under s913B  |
| AML                          | An Australian market licence under s795B  |
| ASIC                         | Australian Securities and Investments Commission  |
| Corporations Act             | The <i>Corporations Act 2001</i> (Cth)  |
| Delaware limited partnership | A limited partnership registered in the state of Delaware, USA  |
| FIFO                         | First-in, first-out trading principle (i.e. orders will be executed based on best price and first in queue of best price) |