



ASIC

Australian Securities & Investments Commission

REPORT 211

Market assessment report: EBS Service Company Limited

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About this report

This report summarises ASIC's fifth annual assessment of EBS Service Company Limited (EBS) under s794C of the *Corporations Act 2001* (Cth) (Corporations Act).

This assessment covers the period 1 January 2009 to 2 March 2010 (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 EBS

EBS was granted an Australian market licence on 14 March 2005. The Australian market licence was varied with effect from 21 December 2006.

Report number	Date released
REP 73	May 2006
REP 104	October 2007
REP 161	June 2009
REP 190	January 2010

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Key findings and recommendations

Key findings

- 1 ASIC is satisfied that EBS has:
 - adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c) of the 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 We do not have any recommendations to make in relation to EBS's current supervisory arrangements.

A The assessment

Key points

ASIC conducts annual assessments of market licensees, such as EBS, 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 Under s792A(c) a market licensee is required to have adequate arrangements for supervising the 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.
- 4 ASIC is required to assess how well a market licensee complies with its obligations in s792A(c) at least once a year: s794C(2).
- 5 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). In this instance, we extended the scope of the assessment to include a review of whether EBS had sufficient financial, technological and human resources to comply with its obligations under s792A(d).
- 6 This report covers the period from 1 January 2009 to 2 March 2010 (the assessment period). The assessment period was extended beyond the usual calendar year end to 2 March 2010 because EBS became an exempt market operator after this date. This report will be our final assessment report on EBS.

Background

- 7 EBS is a Swiss incorporated subsidiary of ICAP Holdings Limited, which is a wholly owned subsidiary of ICAP plc, a company quoted on the London Stock Exchange. EBS was previously a subsidiary of EBS Group Limited. EBS Group Limited and its subsidiaries were acquired in June 2006 by ICAP plc. The acquisition of EBS and EBS Group Limited has not affected the Australian market licence of EBS or its obligations as a market licensee.
- 8 From an operational perspective, EBS Group Limited and its affiliates, including EBS (together, the EBS Group), are managed as a single group by the Executive Management Team made up of staff employed by affiliated companies EBS Dealing Resources, Inc., EBS Dealing Resources International Limited and other subsidiaries of ICAP plc. In the case of EBS, the Executive Management Team provides recommendations to the directors of EBS and, if approved by the directors, these recommendations are implemented by the Executive Management Team. EBS has no direct employees in Australia because human resources available to EBS (outside of Switzerland) are provided through other ICAP plc group subsidiaries.
- 9 On 14 March 2005, EBS was granted an Australian market licence under s795B(1), authorising it to operate the market known as EBS Spot in Australia. This market licence was varied on 21 December 2006 to permit EBS to facilitate trading in two additional precious metals: palladium and platinum. A copy of the market licence and variation are available on our website at www.asic.gov.au/markets.
- 10 EBS Spot is an electronic deal-matching trading system that facilitates trading by participants in spot foreign exchange, foreign exchange derivatives and spot precious metals (i.e. gold, silver, palladium and platinum). Operating a market to facilitate the trading of spot precious metals does not require a market licence in Australia.
- 11 In accordance with its market licence, EBS has been trading non-deliverable forwards on EBS Spot since March 2008. Non-deliverable forwards are short-term foreign exchange contracts in currencies that have restricted convertibility. Currently, the following currencies are available for non-deliverable forward trading on EBS Spot: Argentine peso (ARS), Chilean peso (CLP), Chinese renminbi (CNY), Colombian peso (COP), Korean won (KRW), Indian rupee (INR), Indonesian rupiah (IDR), Malaysian ringgit (MYR), Peruvian nuevo sol (PEN), Philippine peso (PHP), Russian rouble (RUB) and Taiwan dollar (TWD).
- 12 Trades are matched automatically by EBS Spot and occur on an anonymous basis with the identity of the counterparty unknown to the participants before the trade is executed. However, the system will only match trades between participants who have previously established mutual credit limits with each

other. All participants on EBS Spot must be professional investors as defined under s761G, dealing on their own behalf or on behalf of professional investor clients only.

- 13 In December 2007, EBS informed us that it wished to apply for EBS Spot to become an exempt professional market—that is, it wished to apply for an exemption from the requirement to hold an Australian market licence for the operation of EBS Spot. EBS’s exemption application was approved by the Minister on 22 February 2010 and became effective after 2 March 2010. EBS was also granted an Australian financial services (AFS) licence on 8 February 2010, thereby satisfying one of the conditions for its market licence exemption.

Our methodology

Our assessment process

- 14 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.
- 15 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 focused on for this assessment

- 16 Our focus of this assessment was to review:
- how well EBS complied with its ongoing supervisory and reporting obligations under its Australian market licence and the Corporations Act during the assessment period; and
 - the adequacy of EBS’s financial, technological and human resources to operate and supervise its market.

What we considered

- 17 In conducting our assessment we considered:
- the previous s794C annual assessment report (REP 190);

- EBS's s792F annual regulatory report to ASIC for the extended period 1 January 2009 to 2 March 2010 (received 26 April 2010);
- EBS's six-monthly reports to ASIC;
- information we received from and about EBS in the ordinary course of our dealings;
- information from the media and EBS's website;
- how well EBS might comply with its obligations in the future; and
- EBS's financial statements as at 31 March 2010.

Consultation

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

B Our observations for EBS

Key points

We have considered the adequacy of EBS's arrangements for supervising 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.

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

We do not have any recommendations to make in relation to EBS's current supervisory arrangements.

Supervisory arrangements

- 19 We conclude that EBS has adequate arrangements for the supervision of its market in accordance with its obligations under s792A(c).
- 20 Our conclusion is based on the assessment that we conducted and the following observations:
- we are not aware of EBS substantially changing the arrangements it has in place for supervising the market from the description provided in its Australian market licence application;
 - no serious market failures or disruptions have come to our attention; and
 - during the assessment period no information came to our attention to suggest that the supervisory arrangements in place were not operating properly.
- 21 In summary, EBS's supervisory arrangements comprise three key elements. First, the Group General Counsel based in London has overall responsibility for the compliance function within EBS and is assisted by employees within ICAP plc's legal, human resources, risk management and finance departments. Second, the Regional General Counsel for Asia based in Hong Kong is responsible for monitoring conflicts of interest between the EBS Group's commercial and supervisory obligations. Third, EBS Spot participants are required to perform a self-monitoring role by appointing an

employee as the Trading Floor Administrator to ensure that they comply with the operating rules, written policies and procedures.

Managing conflicts of interest

- 22 In its s792F annual regulatory report, EBS stated its awareness that there may be conflicts of interest between its commercial interests and its supervisory duties and has the following arrangements for managing such conflicts:
- operating rules and written procedures are in place that set out clear outlines by which participants and EBS as a market licensee must operate;
 - written internal policies and procedures are in place that specifically deal with issues arising from actual or potential conflicts of interest;
 - EBS uses objective criteria to determine whether an entity should be admitted as a participant of the market;
 - three Regional General Counsels are appointed and provided with the opportunity to identify conflicts of interest between EBS Group's commercial and supervisory obligations;
 - EBS's ultimate parent, ICAP plc, undertakes reference checks on new employees for possible conflicts of interest;
 - there is structural separation of commercial and supervisory activities within the EBS Group (e.g. supervisory activities are generally undertaken at the ICAP plc level); and
 - any decisions in relation to disciplinary action would be made by ICAP plc's Executive Management Team in discussion with EBS.
- 23 We note that EBS Spot is restricted to professional investors. EBS has reported that no issues were raised by participants on EBS Spot.
- 24 EBS has submitted that there were no significant conflict of interest events occurring during the assessment period.
- 25 We consider that EBS's arrangements for managing conflicts of interest are adequate, taking into account the nature of the market and its participants.

Monitoring the conduct of participants and trading activity

- 26 In its s792F annual regulatory report, EBS submits that its supervisory arrangements for monitoring the conduct of participants on and in relation to EBS Spot are adequate when the nature of EBS Spot and its participants are taken into account.
- 27 The nature of EBS Spot and participants on the market are as follows:

- users of EBS Spot are professional investors;
 - each participating entity has previously satisfied itself as to the credit risk of its counterparty prior to entering any particular deal; and
 - EBS Spot is a fully automated deal-matching system.
- 28 EBS has the following mechanisms for monitoring the conduct of participants:
- EBS warns participants if they enter an aberrant price (one that deviates significantly from the market price as determined by a series of algorithms incorporated into the market's operating systems);
 - EBS will take any action it deems necessary and within its power if it becomes aware of a participant's breach of its operating rules;
 - EBS has the right to access a participant's trading floor for the purpose of confirming that the participant is complying with the operating rules. EBS notes in its s792F annual regulatory report that it did not exercise its right to access the trading floor of any participant; and
 - EBS Spot participants are required to perform a self-monitoring role by appointing an employee in the role of Trading Floor Administrator who is responsible for the participants' smooth operation of EBS Spot.
- 29 EBS has not raised any issues relating to the monitoring of the market and the conduct of participants during the assessment period.
- 30 We consider that EBS's arrangements for monitoring the conduct of participants are adequate given the nature of the market.

Enforcing compliance with market operating rules

- 31 In its s792F annual regulatory report, EBS submits that it has continued to maintain the arrangements for enforcing compliance with its operating rules which were outlined in its application for an Australian market licence. Under these arrangements, EBS may:
- withdraw a participant's access to, or suspend EBS's provision of, EBS Spot if there has been a breach of the EBS Customer Agreement or a failure to comply with the EBS Spot Dealing Rules;
 - request that a participant terminates an employee's access to EBS Spot if the employee is in breach of the EBS Spot Dealing Rules; and
 - remove any bid or offer from EBS Spot if the bid or offer breaches, or contains material prohibited by, the EBS Spot Dealing Rules, or if it is impairing or reducing the efficiency of the system.
- 32 Under the operating rules, each participant agrees that its obligations to comply with the operating rules are legally enforceable against it by each other participant (as well as by EBS).

- 33 EBS states in its s792F annual regulatory report that it did not need to exercise any of the above rights during the reporting period.
- 34 We consider that EBS has adequate arrangements for enforcing compliance with its operating rules in view of the arrangements listed above, and taking into account the nature of the market and its participants.

Resources

- 35 In our assessment, we reviewed and were satisfied with the adequacy of EBS's resources (including human, technical and financial resources) to operate the markets properly and to provide adequate supervisory arrangements.

Financial resources

- 36 We have reviewed EBS's audited financial statements and consider that EBS has generated sufficient revenue each year to cover the costs of operating its market.

Technological resources

- 37 There has been no serious market disruption during the assessment period and EBS submits that the current technology has coped with existing volumes on EBS Spot.
- 38 In its s792F annual regulatory report, EBS submits that it introduced three new software versions during 2009 that offered new value-added features (new order types and reduction in minimum trading size from one million to one hundred thousand for selected currency pairs) and enhanced the trading experience for customers.

Human resources

- 39 We consider that EBS has sufficient human resources to operate its market properly and to provide the required supervisory arrangements in accordance with its obligations under s792A(d) of the Corporations Act.

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 <p>Note: This is a definition contained in s761A of the Corporations Act.</p>
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 purpose of that Act
EBS	EBS Service Company Limited
EBS Spot	EBS's electronic anonymous deal-matching trading system that facilitates trading by participants in spot foreign exchange and precious metals
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