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Ice Futures U.S. (IFUS) review 2019

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Executive summary

Purpose of this report

ICE Futures U.S., Inc. (IFUS) is licensed to operate the IFUS derivatives market (the derivatives market) in New Zealand. The FMA is required to report, at least once every two years¹, on how well IFUS is meeting its obligations as a licensed market operator².

This review covers the period 1 January 2017 to 31 December 2018. This is our second review of IFUS since it became licensed on 1 December 2014.

The U.S. Commodity Futures Trading Commission (CFTC) is IFUS's primary regulator. Our review therefore focused on whether the CFTC was satisfied with IFUS's compliance during the review period. See the Appendix for details of how we did our review.

Conclusion

We are satisfied that during the review period, IFUS:

- ensured, to the extent reasonably practicable, its licensed market was fair, orderly and transparent
- had adequate arrangements for notifying disclosures from participants in its markets
- had adequate arrangements for handling conflicts between its commercial interests, and the obligation to ensure its market operates in a fair, orderly and transparent manner
- had adequate arrangements for monitoring the conduct of participants in its markets
- had adequate arrangements for enforcing compliance with market rules
- had sufficient resources (including financial, technological and human resources) to operate its licensed market properly.

We based our conclusions largely on the CFTC's oversight of IFUS. The CFTC monitors how IFUS complies with the 23 Core Principles for Designated Contract Markets (core principles) under section 5(d) of the United States' Commodity Exchange Act (CE Act). The CFTC has said it has no reason to believe that IFUS did not comply with the core principles during the review period.

See the 'Findings' section of this report for more details.

¹ A condition of ICE Futures USA's licence is a review every two years.

² The market operator obligations are set out in the Appendix.

About IFUS

IFUS operates a derivatives market. Products traded on the market include futures and options on North American natural gas and power, equity indices, foreign exchange, and commodities such as coffee, cocoa, cotton, sugar and frozen concentrated orange juice.

In the year ended 31 December 2018, about 339 million futures, and options on futures contracts were exchanged on the derivatives market³.

IFUS is a wholly-owned indirect subsidiary of Intercontinental Exchange, Inc. (Intercontinental Exchange), which is listed on the New York Stock Exchange. Intercontinental Exchange owns a number of markets, and clearing and settlement services. These include ICE Clear US and ICE Clear Europe, which provide the clearing and settlement services for IFUS.

IFUS's licence

IFUS was an authorised futures exchange under the Securities Markets Act 1988. It has held a financial product market licence since 1 December 2014, deemed under the transitional provisions of the Financial Markets Conduct Act 2013 (FMC Act). The conditions of [IFUS's licence](#) were largely carried over from the authorised futures exchange notice.

As a designated contract market (DCM – the equivalent of a market operator in New Zealand), IFUS must comply with the 23 core principles set out in Part 38 of the CE Act. The CFTC is its primary regulator.

IFUS's licence conditions require it to tell New Zealand investors it is primarily regulated under US law. It must also ensure any of its members making regulated offers⁴ of derivatives in New Zealand are licensed under the FMC Act, if required.

Every six months, IFUS must give us information about members making derivatives offers in New Zealand. As at 31 December 2018, one IFUS member was registered to offer derivatives here.

IFUS must also notify us if it intends to materially change the rules for the derivatives market. Rule changes must be submitted to the CFTC for review.

Requirements under the Commodity Exchange Act

The core principles under the CE Act contain equivalent obligations to those under the FMC Act, which require licensed market operators to ensure markets are fair, orderly and transparent. Section 314 of the FMC Act more specifically requires licensed market operators to have arrangements to deal with disclosure, conflicts of interest, conduct monitoring, enforcement, and resourcing. More information about the CE Act principles is available on the CFTC's website⁵.

For example, core principle 13, Disciplinary Procedures, requires DCMs to have procedures to discipline, suspend or expel members, market participants or third parties with delegated functions, when they violate rules. In addition,

³ Reports on historic monthly values for ICE Futures USA are available [here](#)

⁴ As defined in the FMC Act

⁵ <https://www.cftc.gov/IndustryOversight/TradingOrganizations/DCMs/index.htm>

they must maintain sufficient enforcement staff and resources for timely enforcement action, and establish disciplinary panels that are sufficiently independent of internal compliance staff. This corresponds to the FMC Act's requirement for market operators to have adequate arrangements for enforcing compliance with relevant market rules (such as an independent adjudicative body to adjudicate on contraventions of market rules that are referred to it).

A number of core principles on trading and post-trading transparency are targeted specifically towards the fair, orderly and transparent operation of markets.

Core principle 16, Conflicts of Interest, requires DCMs to establish and enforce rules "to minimise conflicts of interest in the decision-making process of the contract market" and "to establish a process for resolving [those] conflicts of interest". This corresponds to a similar key obligation under the FMC Act for market operators to have adequate arrangements in place to handle conflicts between commercial interests and regulatory functions.

Core principle 20, System Safeguards, requires DCMs to establish and maintain a risk analysis and oversight programme for their operations and automated systems. In September 2016, enhancements to this core principle were adopted to include new cyber-security testing provisions. This obligation corresponds in part to a similar FMC Act obligation on market operators to have sufficient resources (including financial, technological and human resources) to operate their licensed markets properly.

IFUS must follow a number of additional regulatory reporting obligations set by the CFTC under the CE Act. These require DCMs to submit [rule filings](#) to the CFTC if there are any rule changes.

IFUS must also file quarterly financials with the CFTC to show it complies with core principle 21(B), which essentially requires DCMs to be able to cover their operating costs for a one-year period. These financial filings are not published.

Besides the core principles of the CE Act, IFUS must also comply with regulations set by the CFTC for US DCMs.

Findings

Our review focused on whether the CFTC was satisfied with IFUS's compliance during the review period, and how it reached that view⁶.

The CFTC's oversight of IFUS

The CFTC's Division of Market Oversight (DMO) monitors IFUS's ongoing compliance. The CFTC's oversight includes rule enforcement reviews (RERs) of how IFUS complies with the core principles, and with the CFTC's regulations and guidance. More information is available [here](#) about how the CFTC carries out its RERs.

During the review period, the DMO completed one RER that evaluated IFUS's compliance with core principle 13 (Disciplinary Procedures). A high-level review of IFUS's products and trading volume, investigations, disciplinary cases, staffing, conflict of interest policies, technology, and market maker and incentive programmes was also conducted.

The DMO also completed a System Safeguards Examination in accordance with core principle 20.

⁶ Further information on our approach is available in the Appendix

The CFTC confirmed that no material recommendations were made in respect of these reviews.

In addition to the RERs, the DMO conducted two high-level reviews in 2018 across multiple exchanges, including IFUS, to identify topics for CFTC's compliance examination priorities for 2019. As a result of these reviews, IFUS underwent two in-depth on-site examinations in respect of two of the eight examination priority topics identified: surveillance for disruptive trading practices, and block trade surveillance practices. Both examinations are expected to be completed by December 2019.

Separate to any examinations carried out, the DMO maintains regular contact with IFUS for updates on any significant changes, and receives self-certifications from IFUS on its compliance with rules.

The CFTC receives IFUS Notices, and advises that it is satisfied with the enforcement approach and fines imposed by IFUS in respect of disciplinary action taken against market participants.

Overall, the CFTC confirmed that it does not have any significant concerns with IFUS and has no reason to consider that IFUS did not comply with the core principles and its obligations during the review period.

Disclosure requirements

The FMC Act requires market operators to notify the market of disclosures from listed issuers, substantial holders of listed issuers, and directors and senior managers of listed issuers about their relevant interests. As IFUS does not list any single stock futures or equity products on the derivatives market, these particular disclosures do not apply.

Under core principle 8, IFUS must "make public daily information on settlement prices, volume, open interest, and opening and closing ranges for actively traded contracts on the contract market". IFUS has complied with this core principle by making this information available through its 'Daily Market Report'. This is posted on its website and faxed or mailed to individuals on request.

This core principle is a satisfactory equivalent to the FMC Act obligation relating to products listed on the derivatives market. We are satisfied that, by complying with this core principle, IFUS met the purpose of the FMC Act's disclosure obligation.

IFUS's self-assessment

In accordance with section 337 of the FMC Act and Condition 12 of its licence, IFUS gave us a self-assessment report on how it met its obligations under section 314 of the FMC Act for the two financial periods ended 31 December 2017 and 31 December 2018. IFUS explained how it complied with each of its FMC Act obligations and, where appropriate, referred to the equivalent core principles of the CE Act. We are satisfied that IFUS has adequate arrangements to comply with its FMC Act obligations.

In accordance with the CFTC's guidelines, IFUS has a regulatory oversight committee (ROC) to monitor its compliance with the core principles. The ROC is set up by the board, and made up exclusively of 'public directors'⁷ to assist with minimising actual and potential conflicts of interest. The board must ensure that the ROC has sufficient authority, resources and time to fulfil its mandate.

The ROC oversees the fulfilment of IFUS's compliance with its self-regulatory obligations and advises the board with respect to those obligations. The ROC's role includes oversight of the budget and staffing of IFUS's market regulation department, and assessment of whether the market regulation department is able to discharge its responsibilities with a sufficient degree of independence. The ROC also reviews IFUS's market rules, and the likely impact of market rule

⁷ Under the CFTC's definition, 'public directors' are required to have no 'material relationship' with the DCM

changes on its self-regulatory functions. The market regulation department is responsible for ensuring participant compliance with IFUS rules and policies, monitoring market activities, and investigations.

Conclusion

We are satisfied that IFUS complied with its FMC Act obligations as a licensed market operator during the review period. The reasons are:

- IFUS showed in its self-assessment report that it has adequate arrangements to meet the FMC Act obligations
- the CFTC has said it has no reason to consider that IFUS did not comply with the core principles during the review period.

Appendix: How we conducted our review

Our role

Under the FMC Act, we are required to periodically review and publish our findings on how well a licensed market operator is meeting its obligations.

Market operator obligations

In the FMC Act, 'market operator obligations' means:

- the general obligations contained in section 314 of the FMC Act:
 - to ensure, to the extent reasonably practicable, that each of the licensed markets is fair, orderly and transparent
 - to have adequate arrangements for notifying disclosures from participants in its markets, and for continuing to make them available
 - to have adequate arrangements for handling conflicts between its commercial interests and the obligation to ensure its markets operate in a fair, orderly and transparent manner
 - to have adequate arrangements for monitoring the conduct of participants in its markets
 - to have adequate arrangements for enforcing compliance with market rules
 - to have sufficient resources (including financial, technological and human resources) to operate its licensed markets properly
- an obligation to respond to any request from us to make changes to market rules (section 333)
- an obligation to provide us with an annual self-assessment of how it complies with its obligations (section 337)
- an obligation to act on our, or the Minister's⁸, direction if it has failed to meet any of its obligations (sections 340 to 342)
- any condition of a market operator's licence.

Approach

A market operator that is authorised and regulated in an overseas country may be licensed under the FMC Act if it meets certain conditions.

A key requirement is that the home jurisdiction regulating and supervising the market operator should provide a comparable level of investor protection and market integrity as the FMC Act⁹. This allows us to rely on the overseas

⁸ New Zealand Minister for Commerce and Consumer Affairs

⁹ The original authorisation of ICE Futures USA as a futures exchange was assessed under a similar requirement in the repealed Securities Markets Act 1988. ICE Futures USA was deemed to have a licence from 1 Dec 2014 as it moved to the FMC Act regime.

regulator to assess and monitor the capability and compliance of the market operator. The core principles for DCMs include requirements that are very similar to IFUS's obligations under the FMC Act.

The CFTC actively monitors IFUS's compliance with the core principles. The CFTC can also ask IFUS at any time to demonstrate how it complies with the core principles and its obligations under the CE Act.

Therefore, our approach was to focus on:

- whether the CFTC was satisfied with IFUS's compliance with the core principles during the review period
- how it reached that view.

Information reviewed

A key component of our review was information provided by the CFTC about:

- its oversight of IFUS
- any matters or concerns raised with IFUS during the review period
- how IFUS addressed those matters
- the CFTC's overall view of IFUS's compliance with its obligations as a DCM.

Our review process included communication by telephone and email with the CFTC to discuss these questions.

We also looked at the following:

- IFUS's self-assessment report for the period under review
- information on [Intercontinental Exchange's website](#) about how IFUS approaches its obligations and interprets its obligation to operate fair, orderly and transparent markets
- past RERs of IFUS's compliance with the core principles
- past high-level reviews and current ongoing in-depth reviews in relation to CFTC's compliance examinations priorities for 2019.

Glossary

CE Act	the United States' Commodity Exchange Act
CFTC	U.S. Commodity Futures Trading Commission
Core principles	The 23 Core Principles for US DCMs under section 5(d) of the CE Act
DCM	Designated Contract Markets
Derivatives market	Financial product market IFUS is licensed to operate under the FMC Act
DMO	Division of Market Oversight
FMA	Financial Markets Authority
FMC Act	Financial Markets Conduct Act 2013
IFUS	ICE Futures U.S., Inc.
Intercontinental Exchange	Intercontinental Exchange Inc., the parent company of IFUS
Market operator	A person authorised to operate a licensed market under a financial product market licence
Market rules	All of the rules governing IFUS's licensed market
Member or participant	A participant in the licensed market who has been accredited and approved by IFUS
Regulatory oversight committee (ROC)	A sub-committee of the IFUS board set up to help with compliance with the core principles
Review period	The period from 1 December 2017 to 31 December 2018
Rule enforcement reviews	The CFTC's regular reviews of a DCM's ongoing compliance with the core principles
Self-assessment report	A report from a licensed market operator on compliance with its obligations, required under section 337 of the FMC Act