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# Ice Futures U.S. (IFUS) review 2017

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# Executive summary

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## Purpose of this report

ICE Futures U.S., Inc. (IFUS) is licensed to operate the IFUS derivatives market (the derivatives market) in New Zealand. We are required to report, at least once every two years<sup>1</sup> on how well IFUS is meeting its obligations as a licensed market operator<sup>2</sup>. This review covers the period 1 December 2014 to 31 December 2016. This is our first review of IFUS since it became licensed on 1 December 2014.

The US 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 (DCMs) (core principles) under section 5(d) of the Commodity Exchange Act (CEA). 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.

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<sup>1</sup> A condition of ICE Futures USA's licence is a review every two years

<sup>2</sup> The market operator obligations are set out in the Appendix

# IFUS

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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 2016, about 370 million futures and options on futures contracts were exchanged on the derivatives market<sup>3</sup>.

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. They 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. View its licence [here](#).

As a US DCM, IFUS must comply with the core principles and 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 offers<sup>4</sup> of derivatives in New Zealand are licensed under the FMC Act, if required.

Every six months, IFUS must give the FMA information about members making derivatives offers in New Zealand. As at 31 December 2016, none of IFUS's members were 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 for review to the CFTC.

## Requirements under the CEA

The FMC Act requires licensed market operators to ensure markets are fair, orderly and transparent. They must also have arrangements to deal with disclosure, conflicts of interest, conduct monitoring, enforcement, and resourcing. The core principles contain equivalent obligations.

For example, under core principle 2, DCMs must ensure that appropriate arrangements are made to “establish, monitor, and enforce compliance with the rules of the contract market”.

This corresponds to the FMC Act's requirement for a market operator to have adequate arrangements for enforcing compliance with the relevant market rules.

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

<sup>4</sup> As defined in the FMC Act

A DCM must also 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” (core principle 16). This also corresponds to a similar FMC Act obligation.

The other FMC Act obligations are met through a number of the US core principles.

IFUS must also follow a number of regulatory reporting obligations, made by the CFTC under the CEA. These require DCMs to submit [rule filings](#) to the CFTC if there are any rules changes.

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

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

## Findings

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Our review focused on whether the CFTC was satisfied with IFUS’s compliance during the review period, and how it reached that view<sup>5</sup>.

### The CFTC’s oversight of IFUS

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

During the review period, the CFTC conducted one RER of IFUS. It focused on core principles 2 (Compliance with Rules) and 12 (Protection of Markets and Market Participants), including CFTC regulations for those core principles. A report on the RER was published on 2 December 2016 and can be viewed [here](#).

The RER identified a deficiency in IFUS’s compliance with one regulation. The regulation requires DCMs to complete investigations within one year, unless mitigating circumstances exist. IFUS had closed a number of cases outside the one-year period, and the CFTC recommended actions to address this. The CFTC made three other recommendations following the RER.

IFUS did not breach any of its obligations as a DCM, even though the RER recommended some areas of improvement. The CFTC was satisfied with how IFUS had responded to its recommendations based on the RER.

It said it has no reason to consider that IFUS did not comply with the core principles 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.

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<sup>5</sup> Further information on our approach is found in the Appendix

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 for products listed on the derivatives market. We are satisfied by complying with this core principle, IFUS complied with the intention of the FMC Act’s disclosure obligation.

## IFUS’s self-assessment

As required by the FMC Act, IFUS gave us a self-assessment report on how it met its obligations for the years ended 31 December 2015 and 2016. IFUS explained how it complied with each of its FMC Act obligations, and referred to the equivalent core principles where appropriate. We were satisfied that IFUS had adequate arrangements to comply with its FMC Act obligations.

Based on the CFTC’s guidance, IFUS has a regulatory oversight committee (ROC) to monitor its compliance with the core principles. The CFTC recommended that the ROC be set up by the board, and be made up exclusively of “public directors”<sup>6</sup>. The board of a DCM must ensure that the ROC has sufficient authority, resources, and time to fulfil its mandate.

The ROC oversees the budget and staffing of its market regulation department. The latter is responsible for meeting its compliance obligations and self-regulatory responsibilities. It also reviews IFUS’s market rules, and the likely impact of market rule changes on its self-regulatory functions.

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

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<sup>6</sup> Under the CFTC’s definition, ‘public directors’ are required to have no ‘material relationship’ with the DCM

# Appendix: How we conducted our review

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## 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's<sup>7</sup>, 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, 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

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<sup>7</sup> New Zealand Minister for Commerce and Consumer Affairs



comparable level of investor protection and market integrity as the FMC Act<sup>8</sup>. This allows us to rely on the overseas regulator to assess and monitor the capability and compliance of the market operator. The core principles for DCMs include requirements which 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 CEA.

Our approach was, therefore, 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; and the CFTC's overall view of IFUS's compliance with its obligations as a DCM. Our review process included communication by phone and email with the CFTC to discuss these questions.

We also looked at the following:

- IFUS's self-assessment report
- [Intercontinental Exchange's website](#) information 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.

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<sup>8</sup> 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.

# Glossary

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CEA	US Commodity Exchange Act
CFTC	US Commodity Futures Trading Commission
Core principles	The 23 Core Principles for US DCMs under section 5(d) of the CEA
Derivatives market	Financial product market IFUS is licensed to operate under the FMC Act
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 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 2014 to 31 December 2016
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