ASIC Gazette

Contents

Markets Disciplinary Panel Infringement Notice

Recipient: Instinet Australia Pty Limited

The recipient has complied with the infringement notice. Compliance is not an admission of guilt or liability; and the recipient is not taken to have contravened subsection 798H (1) of the Corporations Act 2001.

PART 7.2A OF THE CORPORATIONS REGULATIONS 2001
INFRINGEMENT NOTICE

To: Instinet Australia Pty Limited
ACN 131 253 686
Level 33, Aurora Place
88 Phillip Street
SYDNEY NSW 2000

TAKE NOTICE: The Australian Securities and Investments Commission ("ASIC") gives this infringement notice to Instinet Australia Pty Limited ("Instinet") under regulation 7.2A.04 of the Corporations Regulations 2001 ("Regulations"). To comply with this notice Instinet must:

> Pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **$130,000**.

This infringement notice is given on 4 June 2013.

The unique code for this notice as required by paragraph 7.2A.06(b) of the Regulations is MDP23990/11.

Certain defined terms used in this notice are set out in the Appendix to this notice.

Alleged contravention and penalty

Instinet was a Trading Participant in the Market operated by ASX Limited at the relevant time and was therefore an entity required by subsection 798H(1) of the *Corporations Act 2001* ("Act") to comply with the market integrity rules at that time.

Instinet is alleged to have contravened subsection 798H(1) of the Act by reason of contravening Rule 5.6.1(a) of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.6.1(a)"), which provides:

> *"A Trading Participant which uses its system for Automated Order Processing must at all times:*
>
> > *(a) have appropriate automated filters, in relation to Automated Order Processing;"*

On the evidence before it, the Markets Disciplinary Panel ("MDP") was satisfied that:

1. From 22 October 2010 to 26 November 2010 (inclusive), Instinet sent Orders on behalf of a client through a Co-Location AOP system, which would either allow the Orders to be submitted onto the Trading Platform or reject them according to the following four filters:
   - Gross Exposure for a Client;
   - Individual Maximum Order Limit;
   - Percentage from Last Traded Price; and
   - Out of Hours Order Placement.

2. From 22 October 2010 to 28 October 2010 Instinet executed 17 Crossings on behalf of the client through the Co-Location AOP system as follows:
   - 6 Crossings in ordinary shares in Kingsgate Consolidated Limited, having ASX code "KCN";
   - 3 Crossings in units in SPDR S&P/ASX 200 Fund, having ASX code "STW"; and
   - 8 Crossings in ordinary shares in Dominion Mining Limited, having ASX code "DOM".

3. From 29 October 2010 to 26 November 2010 ("Relevant Period"), Instinet executed a further 672 Crossings on behalf of the client through the Co-Location AOP system as follows:
   - 478 Crossings in DOM;
   - 50 Crossings in KCN; and
   - 144 Crossings in various other securities.

4. The Crossings ranged in value from $2.97 to $215,696.30.

5. The Crossings all had the same buy/sell trade cross reference of "COL2", being the trade cross reference used by Instinet to identify trades executed on the account of their client.

6. The Crossings involved no change of beneficial ownership as the client of Instinet was trading on behalf of their own account.

7. The orders submitted by the client that resulted in the Crossings, were not rejected as a result of triggering any one of the four Co-Location AOP filters.

8. As a high frequency trader and given its specific trading strategy, the client represented an increased risk of transacting accidental crossings in the market.

9. During the Relevant Period, Instinet created SMARTS Monitoring File Notes, which, inter alia, detail the total number of possible NCBO trades.

10. The 26 SMARTS Monitoring File Notes established that during the Relevant Period there were 860 possible NCBO trades, with the 672 Crossings during that period included in the 860 possibilities.

11. None of the Crossings were cancelled, nor reported to the ASX requesting cancellation.

The MDP considers that in these circumstances at least from the beginning of the Relevant Period, Instinet was required to give consideration to their regulatory obligation and should have applied an appropriate filter to address the issue that is being a wash trade or NCBO filter. By reason of the entry of 672 Crossings during the Relevant Period, via the Co-location AOP system, the MDP found it had reason to believe that Instinet failed to have appropriate automated filters and thereby failed to comply with MIR 5.6.1(a).

As a result of failing to comply with MIR 5.6.1(a), which requires that appropriate automated filters must be used at all times when using AOP systems, Instinet thereby contravened subsection 798H(1) of the Act which requires compliance with the market integrity rules.

Maximum pecuniary penalty that a Court could order

The maximum pecuniary penalty that a Court could order Instinet to pay for contravening subsection 798H(1) of the Act by reason of contravening MIR 5.6.1(a), is $1,000,000.

The maximum pecuniary penalty that may be payable by Instinet under an infringement notice given pursuant to subsection 798K(2) of the Act, is $600,000.

Penalty, under the Infringement Notice

The penalty payable under this infringement notice for the alleged contravention of subsection 798H(1) of the Act and therefore the total penalty that Instinet must pay to the Commonwealth is $130,000.

The penalty is payable to ASIC on behalf of the Commonwealth. Payment is made by bank cheque to the order of the "Australian Securities and Investments Commission".

In determining this matter and the appropriate pecuniary penalty to be applied, the MDP took into account all relevant guidance, including ASIC Regulatory Guide 216 – *Markets Disciplinary Panel* and noted in particular the following:

- The serious nature of the breach;

- MIR 5.6.1 is aimed at ensuring a fair, orderly and transparent trading system, with a strict obligation imposed on Market Participants which use systems for AOP, to ensure that at all times they have appropriate automated filters and that their AOP systems do not interfere with the efficiency and integrity of the Market or the proper functioning of the Trading Platform;

- MIR 5.6.1(a) imposes a mandatory obligation to have appropriate filters as indicated by use of the word "must";

- Instinet's failure to ensure that it had appropriate automated filters in place had the potential to damage the efficiency and integrity of the market. The failure to ensure that AOP systems or direct market access systems have these requisite safeguards, risks undermining public confidence in the market;

- The trades with no change in beneficial ownership did not represent genuine, bona fide trades in the Market, but gave the appearance that they were. As such they interfered with the integrity of the Market and proper functioning of the ASX Trading Platform;

- From at least 29 October 2010, Instinet was aware of Crossings entering into the Market without Instinet having an appropriate filter;

- Instinet was on notice of the NCBO Crossings due to its SMARTS daily post trade reports that reported NCBO trades;

- Instinet failed to enter the SMARTS NCBO alerts in its compliance register or act on them;

- In the circumstances, Instinet ought to have identified the regulatory risk associated with the Crossings on the basis of the SMARTS reports and escalated the issue - including immediately requesting the ASX cancel the NCBO trades;

- The Crossings during the Relevant Period did not represent genuine trades on the Market and in the view of the Panel should have been reported to the ASX in a timely manner and cancellation of them sought;

- From at least 29 October 2010, Instinet was required to give consideration to its regulatory obligation and should have applied an appropriate automated filter to address the issue of the Crossings;

- In the alternative, Instinet was required immediately to deny the client continued access to its Co-location AOP system until the appropriate automated filter was put in place to prevent the Crossings continuing to occur;

- While the breach involved one contravention, it consisted not of an isolated incident, but involved 672 trades occurring over 21 days. Instinet's conduct continued for an unacceptable and extended period of time in the circumstances;

- The MDP noted that during the Relevant Period Instinet did not have effective internal procedures in place to ensure compliance with the mandatory obligations of MIR 5.6.1(a);

- In the MDP's view, these factors were indicative of a serious pattern of non-compliance by Instinet, notwithstanding Instinet's misguided belief that it was entitled to regard the NCBO Crossings as "testing" by the client.

- Instinet did not consider the 672 NCBO crossings that occurred from 29 October 2010 to 26 November 2010 to be a breach, so therefore did not self-report the breach to ASIC;

- Notwithstanding the mistaken belief of Instinet that there was not a breach, Instinet was required to self-report the 672 NCBO crossings to ASIC, and failed to do so;

- Instinet did not take timely action to rectify the breach. It was not until sometime after 28 September 2012 that Instinet included an NCBO filter in its Co-Location AOP system;

- The Panel found that in all the circumstances of the matter, Instinet's misconduct during the Relevant Period, was careless and irresponsible in the context of its regulatory obligations;

- In particular, the Panel found that in all the circumstances of the matter, Instinet's misconduct constituted an unacceptable serious lack of judgment and proper reasonable regard to its mandatory obligation to have in place an appropriate filter during the Relevant Period;

- Instinet has been trading in Australia since February 2010 with no recorded history of non-compliance with the market integrity rules or ASX Market Rules; and

- Instinet co-operated with ASIC throughout its investigation.

Compliance with the Infringement Notice

Instinet may choose not to comply with this infringement notice, but if Instinet does not comply, civil proceedings may be brought against Instinet in relation to the alleged contravention.

To comply with this infringement notice, Instinet must pay the penalty within the compliance period. The compliance period:

    (a)   starts on the day on which the infringement notice is given to Instinet; and

    (b)   ends 27 days after the day on which the infringement notice is given to Instinet;

unless an application is made for its extension.

Instinet may apply to ASIC for an extension of time to comply with this notice under regulation 7.2A.09 of the Regulations. If Instinet does so, and the application is granted, the compliance period ends at the end of the further period allowed.

If Instinet applies for a further period of time in which to comply with this notice, and the application is refused, the compliance period ends on the later of:

    (a)   28 days after the day on which the infringement notice was given to Instinet; and

    (b)   7 days after the notice of refusal is given to Instinet.

Instinet may apply to ASIC for withdrawal of this notice under regulation 7.2A.11 of the Regulations. If Instinet does so, and the application is refused, the compliance period ends 28 days after the notice of refusal is given to Instinet.

Effect of issue and compliance with the Infringement Notice

The effects of compliance with this infringement notice are:

(a)   any liability of Instinet to the Commonwealth for the alleged contravention of subsection 798H(1) of the Act is discharged; and

(b)   no civil or criminal proceedings may be brought or continued by the Commonwealth against Instinet for the conduct specified in the infringement notice as being the conduct that made up the alleged contravention of subsection 798H(1) of the Act; and

(c)   no administrative action may be taken by ASIC under section 914A, 915B, 915C or 920A of the Act against Instinet for the conduct specified in the infringement notice as being the conduct that made up the alleged contravention of subsection 798H(1) of the Act; and

(d)   Instinet is not taken to have admitted guilt or liability in relation to the alleged contravention; and

(e)   Instinet is not taken to have contravened subsection 798H(1) of the Act.

Publication

ASIC may publish details of this infringement notice under regulation 7.2A.15 of the Regulations.

Susan Humphreys
Counsel to the Markets Disciplinary Panel
with the authority of a Division of the Australian Securities and Investments Commission

Dated: 4 June 2013

Appendix – Defined Terms

The terms defined in Rule 1.4.3 of the ASIC Market Integrity Rules (ASX Market) 2010 have the same meaning when used in this notice, including:

"ASX" means ASX Limited (ACN 008 624 691).

"Automated Order Processing" ("AOP") means the process by which orders are registered in a Trading Participant's system, and, if accepted for submission into a Trading Platform by the Trading Participant submitted as a corresponding Trading Message without being keyed or rekeyed by a Designated Trading Representative ("DTR").

"Cross" or "Crossing" means a transaction in respect of which a Trading Participant acts:

   (a) on behalf of both buying and selling to clients to that transaction; or
   (b) on behalf of buying or selling client on one side of that transaction and as Principal on the other side.

"DTR" means a Representative of the Trading Participant who has been authorised by the Trading Participant to submit Trading Messages to the Trading Platform on behalf of the Trading Participant.

"Market Participant" means a Participant in the Market admitted under the Market Operating Rules.

"Market" means the market operated by the Market Operator under Australian Market Licence (Australian Stock Exchange Limited) 2002.

"Order" relevantly means:

   (a) in relation to Cash Market Products, an instruction to purchase or sell Cash Market Products, or an instruction to amend or cancel a prior instruction to purchase or sell Cash Market Products; and

......

"Trading Messages" means those messages submitted into a Trading Platform relating to trading functions, such as Orders, amendment or cancellation of Orders and the reporting or cancellation of Market Transactions on the Trading Platform.

"Trading Permission" means the right to submit Trading Messages in a trading Platform.

"Trading Participant" means a Market Participant which has Trading Permission in respect of one or more products.

"Trading Platform" means a facility made available by the Market Operator to Trading Participants for the entry of Trading Messages, the matching of Orders, the advertisement of invitations to trade and the reporting of transactions.

This notice adopts the following additional definitions of terms as set out below:

"Co-Location" means AOP infrastructure co-located at the ASX data centre.

"SMARTS Monitoring" means a managed service designed for the market surveillance platform which has a transfer between single market and multi-market analysis required for market surveillance functions in cross-market/cross-asset class scenarios. It is designed to conduct internal surveillance of orders, separately to any external monitoring.

"SMARTS Monitoring File Notes" means the daily end of day reports generated by SMARTS Monitoring, that among other things makes a record of anomalous trading that took place during the day, including where there was no change in beneficial ownership.

"NCBO" means no change in beneficial ownership.