



**ASIC**

Australian Securities &  
Investments Commission

Commonwealth of Australia Gazette

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## Contents

### Markets Disciplinary Panel Infringement Notice

**Recipient:** Merrill Lynch Equities (Australia) 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.

#### RIGHTS OF REVIEW

Recipients affected by the decision of the Markets Disciplinary Panel to give them an infringement notice under subsection 798H(1) of the *Corporations Act 2001* and Part 7.2A of the *Corporations Regulations 2001* administered by ASIC may have a right of review or may be entitled to have the infringement notice withdrawn. ASIC has published RG 216 to assist recipients to determine whether they have such rights – see RG 216.71 and RG 216.77 to 216.79. Copies of this document can be obtained from the ASIC website at [www.asic.gov.au](http://www.asic.gov.au)

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## PART 7.2A OF THE CORPORATIONS REGULATIONS 2001 INFRINGEMENT NOTICE

**To:** Merrill Lynch Equities (Australia) Limited  
Level 38, Governor Phillip Tower  
1 Farrer Place  
SYDNEY NSW 2000

**TAKE NOTICE:** The Australian Securities and Investments Commission ("ASIC") gives this infringement notice to Merrill Lynch Equities (Australia) Limited ACN 006 276 795 ("Merrill Lynch") under regulation 7.2A.04 of the Corporations Regulations 2001 ("Regulations"). To comply with this notice Merrill Lynch must:

Pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **\$96,000.**

This infringement notice is given on 7 August 2014.

The unique code for this notice as required by paragraph 7.2A.06(b) of the Regulations is MDP20034/13.

The terms defined in Rule 1.4.3 of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 1.4.3") have the same meaning when used in this notice, including those set out in the Appendix to this notice. Certain additional defined terms used in this notice are also set out in the Appendix to this notice.

### **Alleged contravention and penalty**

Merrill Lynch was a Trading Participant in the Market operated by the ASX 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.

Merrill Lynch is alleged to have contravened subsection 798H(1) of the Act by reason of contravening Rules 5.6.1 and 5.9.1 of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.6.1" and "MIR 5.9.1").

MIR 5.6.1 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; and*  
*(b) ensure that such use does not interfere with:*  
*(i) the efficiency and integrity of the Market; or*  
*(ii) the proper functioning of any Trading Platform."*

MIR 5.9.1 provides:

*"A Market Participant must not do anything which results in a market for a Product not being both fair and orderly, or fail to do anything where that failure has that effect."*

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

- 1) On 28 February 2012 at about 15:40:11, a Direct Market Access ("DMA") client of Merrill Lynch ("Client") entered an Order into Merrill Lynch's Automated Order Processing ("AOP") system to sell 49,000 Class A non-voting common stock in News Corporation Inc., having ASX code 'NWSLV', at a price of \$0.43 ("Initial Order"). The Initial Order comprised in part, an Order to sell 35,334 NWSLV at a price of \$0.43 ("Relevant Order").
- 2) Immediately prior to the entry of the Initial Order by the Client into Merrill Lynch's AOP system and before submission of the Relevant Order into the ASX Trading Platform, the market for NWSLV was as follows:
  - a single Bid for 150 NWSLV at \$17.98; and
  - the last traded price for NWSLV was \$17.96.
- 3) At about 15:40:11.219, the Relevant Order was submitted through Merrill Lynch's AOP system into the ASX Trading Platform without triggering an AOP filter (or automated filter) and; no internal warning messages were received by Merrill Lynch despite the Relevant Order being about 97.6% lower in price than the last traded price of \$17.96.
- 4) The Relevant Order traded with Bids in the market for NWSLV, as follows:
  - immediately traded in one Market Transaction for 150 NWSLV at \$17.98, leaving Merrill Lynch with a residual Relevant Order for 35,184 NWSLV at \$0.43; and
  - between 15:40:11.260 and 15:40:19.598, other participants entered Bids for NWSLV at \$0.43 that then traded with the residual Relevant Order and resulted in 13 Market Transactions for a total of 14,486 NWSLV at \$0.43 ("Relevant Transactions").
- 5) The Relevant Transactions resulted in a 97.6% decrease in the traded price of NWSLV.
- 6) Each of the Relevant Transactions fell within the Extreme Cancellation Range ("ECR") under procedure 3200 of the ASX Operating Rules Procedures ("Procedure 3200").
- 7) Merrill Lynch within about eight seconds after submission of the Relevant Order into the ASX Trading Platform identified the error and cancelled the residual or unfilled part of the Relevant Order for 20,698 NWSLV at \$0.43.
- 8) Merrill Lynch then contacted the ASX to facilitate cancellation of the Relevant Transactions under the ECR in accordance with Procedure 3200.
- 9) Between about 15:52:50 and 15:55:20, each of the Relevant Transactions was cancelled.

10) The Relevant Order was submitted into the ASX Trading Platform without triggering an AOP filter because:

- (a) In October 2011, Merrill Lynch upgraded its AOP system (supplied by a third party software vendor) to accommodate the introduction of market competition. As part of the upgrade, a bridge was used to transfer the DMA Order flow received for the Client's account from Merrill Lynch's previous AOP system to its upgraded AOP system ("Bridge").
- (b) In November 2011, the Client's DMA account was migrated from Merrill Lynch's previous AOP system to its upgraded AOP system:
  - although Merrill Lynch's previous AOP system contained an Order Range Percentage ("ORP") automated filter applicable to Orders entered by or on behalf of the Client's account, this filter did not behave as expected;
  - the ORP automated filter within Merrill Lynch's previous AOP system had limits set for both aggressive and passive Orders;
  - unknown to Merrill Lynch, the ORP automated filter when applied in its upgraded AOP system via the Bridge, acted only as a passive filter; and
  - as a result, no internal warning messages were received by Merrill Lynch through its AOP system on receipt of the Initial Order and before the submission of the Relevant Order into the ASX Trading Platform.

By reason of Merrill Lynch's entry of the Relevant Order into the ASX Trading Platform on 28 February 2012, the MDP has reasonable grounds to believe that Merrill Lynch has contravened MIR 5.6.1 and MIR 5.9.1 and thereby contravened subsection 798H(1) of the Act in that:

- Merrill Lynch failed to have in place an appropriate automated price filter for one client account, which interfered with the efficiency and integrity of the Market; and
- Merrill Lynch's misconduct resulted in a market not being both fair and orderly as the Relevant Order caused the price of NWSLV to decrease from \$17.96 to \$0.43, representing a decrease of about 97.6%.

#### **Maximum pecuniary penalty that a Court could order**

The maximum pecuniary penalty that a Court could order Merrill Lynch to pay for contravening subsection 798H(1) of the Act:

- by reason of contravening MIR 5.6.1, is \$1,000,000;
- by reason of contravening MIR 5.9.1, is \$1,000,000.

The maximum pecuniary penalty that may be payable by Merrill Lynch under an infringement notice given pursuant to subsection 798K(2) of the Act:

- by reason of allegedly contravening MIR 5.6.1, is \$600,000;
- by reason of allegedly contravening MIR 5.9.1, is \$600,000.

## Penalty under the Infringement Notice

The penalties imposed by the MDP for the alleged contraventions of subsection 798H(1) of the Act are as follows:

- MIR 5.6.1 – \$70,000;
- MIR 5.9.1 – \$50,000.

However, the MDP considered it appropriate in this matter, to adjust the total sum of the separate penalties as set out above, to ensure that the final penalty payable was just, and appropriate and not excessive, having regard to the totality of the conduct, and other relevant factors. In doing so, the MDP had regard to paragraphs RG 216.125 and RG 216.126 of ASIC Regulatory Guide 216–*Markets Disciplinary Panel* ("RG 216") and applied the totality principle in arriving at the appropriate pecuniary penalty to apply in this matter.

On this basis, and in accordance with subparagraphs 7.2A.06(g)(i) and (ii) and subregulation 7.2A.07(2) of the Regulations, for the alleged contraventions of subsection 798H(1) of the Act, the MDP imposed a total pecuniary penalty of \$96,000.00, as follows:

- MIR 5.6.1 – \$56,000;
- MIR 5.9.1 – \$40,000.

Therefore, the total penalty that Merrill Lynch must pay to the Commonwealth is **\$96,000**, being the penalty payable under this infringement notice for the alleged contraventions of subsection 798H(1) of the Act. \_\_

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 RG 216, and noted in particular the following:

- MIR 5.6.1 is aimed at promoting confidence in the integrity of the market. Imposing a strict obligation on Trading Participants which use their systems for AOP to at all times have appropriate automated filters and ensure that such use does not interfere with the efficiency and integrity of the Market or the proper functioning of the Trading Platform, is critical in maintaining the integrity of the market;
- Appropriate automated filters are essential components of AOP systems used by DMA clients of Trading Participants. Appropriate automated filters are in place to ensure Orders are submitted into the Trading Platform without interfering with the efficiency and integrity of the Market or the proper functioning of the Trading Platform;
- Merrill Lynch failed to ensure that at all times its AOP system had in place an appropriate automated price filter, and failed to ensure that the automated price filter functioned as expected for the Client's account. These failures had the potential to undermine public confidence in the integrity of the market;

- MIR 5.9.1 is similarly aimed at promoting confidence in the integrity of the market. Imposing a strict obligation on Market Participants not to do anything which results in a market for a Product not being both fair and orderly, is also critical in maintaining the integrity of the market;
- The misconduct had the potential to damage the reputation and integrity of the market, as the submission of the Relevant Order into the ASX Trading Platform caused the price of NWSLV to decrease from the last traded price of \$17.96 to \$0.43, being a decrease of about 97.6%;
- The breaches were of a serious nature and had the potential to undermine confidence in the market;
- While there were two breaches of the market integrity rules, being one breach of MIR 5.6.1 and one breach of MIR 5.9.1, both breaches arose from a single source of conduct;
- The misconduct was negligent as Merrill Lynch failed to ensure that at all times its AOP system had in place an appropriate automated price filter in relation to the Client's account;
- Merrill Lynch had a significant history of non-compliance with both the ASX Market Rules and the market integrity rules. Merrill Lynch had previously been sanctioned by the ASX Disciplinary Tribunal on 10 occasions since 2005. Two of these previous matters involved five comparative MIR 5.9.1 contraventions. Merrill Lynch had one prior AOP contravention found against it by the MDP in Infringement Notice – MDP 02/13 dated 31 May 2013, relating to Rule 5.6.3(a) of the ASIC Market Integrity Rules (ASX Market) 2010. The MDP reiterated that any future, repeat contraventions in similar or comparable matters would not be viewed favourably;
- Merrill Lynch took action as soon as the breach was detected in accordance with relevant ASX Operating Rules Procedures to facilitate cancellation of the Relevant Transactions by the ASX;
- Merrill Lynch took the following steps to prevent recurrence of the breaches:
  - conducted a manual review of automated filters across its AOP system;
  - established an enhanced process for limit changes to automated filters, including a 'four-eyes' principle and a requirement for all changes to be approved by the Global Markets Chief Operating Officer;
  - developed an extensive automated formal 'user acceptance testing' protocol that applies to AOP system changes, including the upgraded AOP system in question;
  - implemented an automated daily review comparing filter settings on trade day ("T") with those on T+1, with discrepancies and exceptions escalated to Merrill Lynch management and compliance; and

- introduced 'rule-based' verification with exceptions escalated to Merrill Lynch management and compliance;
- Merrill Lynch co-operated with ASIC throughout its investigation and did not dispute any material facts; and
- Merrill Lynch agreed not to contest the matter, thereby saving time and costs that would otherwise have been expended.

### **Compliance with the Infringement Notice**

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

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

- (a) starts on the day on which the infringement notice is given to Merrill Lynch; and
- (b) ends 27 days after the day on which the infringement notice is given to Merrill Lynch;

unless an application is made for its extension.

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

If Merrill Lynch 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 Merrill Lynch; and
- (b) 7 days after the notice of refusal is given to Merrill Lynch.

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

### **Effect of issue and compliance with the Infringement Notice**

The effects of compliance with this infringement notice are:

- (a) any liability of Merrill Lynch to the Commonwealth for the alleged contravention of subsection 798H(1) of the Act is discharged;
- (b) no civil or criminal proceedings may be brought or continued by the Commonwealth against Merrill Lynch 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;



- (c) no administrative action may be taken by ASIC under section 914A, 915B, 915C or 920A of the Act against Merrill Lynch 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;
- (d) Merrill Lynch is not taken to have admitted guilt or liability in relation to the alleged contravention; and
- (e) Merrill Lynch 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 & Investments Commission

Dated: 7 August 2014

Note: Members of the Markets Disciplinary Panel constitute a Division of ASIC as delegates of the members of the Division for the purposes of considering the allegations covered by this notice.



### Appendix – Defined Terms

The terms defined in MIR 1.4.3 have the same meaning when used in this notice, including:

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

"Automated Order Processing" 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 corresponding Trading Messages without being keyed or rekeyed by a DTR.

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

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

"Market Transaction" means a transaction for one or more Products, entered into on a Trading Platform or reported to the Market Operator under the Market Operating Rules.

"Order" relevantly means:

- (a) In relation to Cash Market Products, an instruction to purchase or sell Cash Market Products...

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

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

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

"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:

"Direct Market Access" means an Order submitted by a client of a Trading Participant into the Trading Participant's system and subject to Automated Order Processing.

"Extreme Cancellation Range" means the range set out in procedure 3200 of the ASX Operating Rules Procedures as defined in rule [7100] of section 7 of the ASX Operating Rules as at 28 February 2012.