

### **DISCIPLINARY MATTER – Australian Investment Exchange Limited**

Australian Investment Exchange Limited ("AUSIEX") has paid a penalty of **\$130,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel ("MDP").

The penalty was for AUSIEX:

- failing to have in place organisational and technical resources, including having:
  - automated filters or Market Vetting Filters as appropriate, for all Authorised Persons between 31 January 2011 and 31 March 2014; and
  - processes to detect Authorised Persons trading without appropriate automated filters in place

which interfered with the efficiency and integrity of the Market; and

- Failing to prevent the entry into the ASX Trading Platform of an erroneous Order which resulted in the market for Westpac Banking Corporation American Call Option contracts not being both fair and orderly.

#### **Background and circumstances**

AUSIEX is alleged to have contravened subsection 798H(1) of the *Corporations Act 2001* ("Corporations Act") by reason of contravening Rules 5.6.3(a) and 5.9.1 of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.6.3(a)" and "MIR 5.9.1").

At the relevant time, MIR 5.6.3(a) provided that:

*"A Trading Participant which uses its system for Automated Order Processing must ensure that the system has in place:*

*(a) organisational and technical resources, including having appropriate automated filters, filter parameters and processes to record any changes to the filters or filter parameters, to enable Trading Messages to be submitted into the Trading Platform without interfering with the efficiency and integrity of the Market or the proper functioning of the Trading Platform;"*

The rule has since been amended to reflect developments in Trading Participants' systems and ASIC's expectations of those systems.

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 MDP was satisfied that:

- 1) On 27 March 2014 at 12:18:37, a representative ("Representative") of a Direct Market Access ("DMA") client of AUSIEX ("Client") entered an Order into one of AUSIEX's Automated Order Processing ("AOP") systems to sell 436 Westpac Banking Corporation American Call Option contracts, having ASX code 'WBCWZ9', at a price of \$0.005 per contract ("Relevant Order").
- 2) At 12:18:51.319, without any automated filter alerts or warnings being triggered, AUSIEX's AOP system submitted the Relevant Order into the ASX Trading Platform.
- 3) Immediately prior to the submission of the Relevant Order through AUSIEX's AOP system into the ASX Trading Platform, the priority Bid for WBCWZ9 was \$0.475 and the last traded price was \$0.520.
- 4) The Relevant Order transacted in full on the ASX Trading Platform resulting in the following three Market Transactions:
  - at 12:18:51.319, a Market Transaction for 137 WBCWZ9 by matching with and consuming the entire priority Bid at \$0.475 ("Trade 1");
  - at 12:18:51.320, a Market Transaction for 200 WBCWZ9 at \$0.005 ("Trade 2"); and
  - at 12:18:51.320, a Market Transaction for 99 WBCWZ9 at \$0.005 ("Trade 3").
- 5) The Market Transactions at \$0.005 caused the price of WBCWZ9 to decrease by \$0.515, being 99% lower than the last traded price prior to the entry of the Relevant Order.
- 6) At approximately 12:25:00, another representative of the Client notified AUSIEX that the Relevant Order had been entered at an erroneous price. AUSIEX then sought cancellation of Trades 1, 2 and 3. At 12:38:21, ASX cancelled Trades 2 and 3.
- 7) AUSIEX subsequently conducted an investigation and initially determined as follows. That of the users granted access to enter Orders via AUSIEX's AOP system ("Authorised Persons") during the period 31 January 2011 to 31 October 2014, 11 Authorised Persons (including the Representative), did not have the following automated filters ("Market Vetting Filters") applied to their Orders:
  - Valid price steps (Bid/Ask);
  - Valid price steps from last trade;
  - Percentage from Bid/Ask;
  - Percentage from last trade; and
  - Small order value.

- 8) On 28 March 2014, AUSIEX applied Market Vetting Filters to the Representative and on 31 March 2014, applied the same to the remaining 10 Authorised Persons.
- 9) AUSIEX's investigation further identified that Orders entered by the 11 Authorised Persons had not been subject to the Market Vetting Filters for the following reasons:
  - the Market Vetting Filters had not been manually applied when the Authorised Person was granted connectivity; or
  - the Authorised Person's settings were 'mirrored' from another Authorised Person who had been initially granted connectivity without Market Vetting Filters.
- 10) Relevantly, when the Representative was given connectivity to AUSIEX's AOP system, AUSIEX had failed to apply the Market Vetting Filters.
- 11) This failure occurred because the electronic request to grant the Representative connectivity had requested that the IT team 'mirror' the settings of another Authorised Person who did not have Market Vetting Filters correctly applied at origination. The Authorised Person whose settings were 'mirrored' did not have Market Vetting Filters applied because the request to provide that person with trading access did not specifically state that Market Vetting Filters were required.
- 12) The AUSIEX investigation also examined the effectiveness of the AOP Annual Review and Quarterly Market Access Reviews given both types of reviews had failed to detect the absence of Market Vetting Filters for the 11 Authorised Persons. It found:
  - the most recent Annual Review was ongoing as at the date of the Relevant Order. The review team had been given data which incorrectly showed that Market Vetting Filters were in place for the 11 Authorised Users, although the review had been suspended to obtain further data which should have identified the issue;
  - the preceding Annual Review had not identified the issue because the staff conducting the review did not properly understand the application of the filters in AUSIEX's AOP system; and
  - the Quarterly Market Access Reviews did not provide sufficient detail to confirm whether Market Vetting Filters on the instance of AUSIEX's AOP system were applied, active and functioning, at an individual account or user level.

By reason of AUSIEX's entry of the Relevant Order into the ASX Trading Platform on 27 March 2014, the MDP has reasonable grounds to believe that AUSIEX has contravened MIR 5.6.3(a) and MIR 5.9.1 and thereby contravened subsection 798H(1) of the Corporations Act.

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

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

- by reason of contravening MIR 5.6.3(a), is \$1,000,000;
- by reason of contravening MIR 5.9.1, is \$1,000,000.

Pursuant to subsection 798K(2) of the Corporations Act, the maximum pecuniary penalty that may be imposed by the MDP and payable by AUSIEX under an infringement notice given for allegedly contravening subsection 798H(1) of the Corporations Act:

- by reason of contravening MIR 5.6.3(a), is \$600,000;
- by reason of contravening MIR 5.9.1, is \$600,000.

### **Penalty under the Infringement Notice**

The penalties payable under the infringement notice for the alleged contraventions of subsection 798H(1) of the Corporations Act, are as follows:

- MIR 5.6.3(a) - \$95,000;
- MIR 5.9.1 - \$35,000.

### **Relevant factors**

In determining this matter and the appropriate pecuniary penalty to be applied, the MDP took into account all relevant guidance and noted in particular the following:

- i. MIR 5.6.3(a) is aimed at promoting confidence in the integrity of the market. Ensuring that Trading Participants with AOP systems have in place adequate organisational and technical resources to operate without interfering 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. This includes having:
  - appropriate automated filters in place; and
  - fully functional or effective processes to detect when appropriate automated filters are not in place;
- ii. appropriate automated filters are essential components of AOP systems used by DMA clients of Trading Participants. Appropriate automated filters are in place to ensure DMA client Orders entered through Trading Participant AOP systems are submitted into the Trading Platform without interfering with market integrity. For this reason, it is incumbent on Trading Participants to ensure that their AOP systems have appropriate automated filters in place, and that their AOP systems comply with the market integrity rules. Accordingly, Trading Participants must have robust and effective processes and controls to detect when appropriate automated filters are not in place. This includes:
  - having skilled staff and technical capabilities that are commensurate with the demands of using a system for AOP; and
  - fostering a culture conducive to compliance with the market integrity rules (e.g. effective educational and compliance programs);
- iii. AUSIEX failed to ensure that at all times its AOP system had in place or had activated appropriate automated filters and failed to ensure that it had fully functional or effective processes to detect Authorised Persons trading without appropriate automated filters in place. The failure of AUSIEX to ensure that its AOP system had these safeguards risked undermining public confidence in the integrity of the market;

- iv. 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 critical in maintaining the integrity of the market;
- v. the submission of the Relevant Order into the ASX Trading Platform through AUSIEX's AOP system caused the price of WBCWZ9 to decrease from \$0.520 to \$0.005, being a significant decrease or variability of 99%, which had the potential to impact the market;
- vi. while there were two alleged breaches of the market integrity rules, being one of MIR 5.6.3(a) and one of MIR 5.9.1, both alleged breaches arose from a single course of conduct;
- vii. the misconduct was of a serious nature as it had the potential to undermine confidence in the integrity of the market;
- viii. the misconduct was careless on the part of AUSIEX. AUSIEX neglected to ensure that at all times its AOP system had in place or had activated, appropriate automated filters in relation to all Authorised Persons. The misconduct was also indicative of a systemic failure including across Trading, Compliance and IT;
- ix. increased caution and diligence ought to be exercised by Trading Participants in the 'mirroring' of accounts or otherwise. Each request for access to any system ought to be considered individually and on its merits and not merely copied over from another user's identical access;
- x. the misconduct was particularly egregious as it transpired over an unacceptable length of time being a period of up to approximately 38 months;
- xi. AUSIEX re-executed Trade 1 at an improved price so that the Client was not disadvantaged. Although the misconduct did not appear to result in any benefit to AUSIEX or detriment to other third parties, the potential to gain benefit or cause detriment through unrestricted or un-vetted AOP system access, was real and apparent;
- xii. while the MDP had regard to AUSIEX self-reporting the breach of MIR 5.6.3 to ASIC, it also noted that a representative of the Client initially notified AUSIEX, and made AUSIEX aware, that the Relevant Order had been entered at an erroneous price;
- xiii. AUSIEX took immediate action on becoming aware of the Relevant Order in accordance with relevant ASX Operating Rules Procedures, to facilitate cancellation of Trade 2 and Trade 3;
- xiv. AUSIEX took steps to prevent recurrence of the breaches, including:
  - immediately instigating an investigation into the cause of the resultant Market Transactions;
  - on 28 March 2014, applying the Market Vetting Filters to the Client's account;

- on 31 March 2014, applying the Market Vetting Filters to the 10 other relevant client accounts;
  - no longer permitting connectivity requests by way of 'mirroring' accounts;
  - introducing an automated solution for the granting of connectivity to new accounts;
  - refreshing procedure documentation to include the requirement of two independent sign-offs/approvals from senior management prior to the creation of new user accounts or filter amendments being actioned;
  - amending review procedures including to the Quarterly Market Access Review to ensure that automated filters have been applied to new accounts;
  - training of all relevant AUSIEX staff by an AOP system subject matter expert including in user and account creation, and the setting of appropriate automated filters; and
  - adding a new staff member whose role is to ensure all AOP system administration functions are performed correctly;
- xv. AUSIEX had no prior contraventions found against it by the MDP, but had been sanctioned by the ASX Disciplinary Tribunal on three occasions relating to non-compliance with the ASX Market Rules. In addition, AUSIEX offered and ASIC accepted an Enforceable Undertaking in 2013 regarding unrelated conduct;
- xvi. AUSIEX co-operated with ASIC throughout its investigation and did not dispute any material facts; and
- xvii. AUSIEX agreed not to contest the matter, thereby saving time and costs that would otherwise have been expended.

### **The Markets Disciplinary Panel**

The MDP is a peer review body that exercises ASIC's power to issue infringement notices and accept enforceable undertakings in relation to alleged breaches of the market integrity rules. The market integrity rules are made by ASIC and apply to market operators, market participants and prescribed entities under the Corporations Regulations 2001 ("Regulations").

### **Additional regulatory information**

Pursuant to subparagraphs 7.2A.15(4)(b)(i) and (ii) of the Regulations, AUSIEX has complied with the infringement notice, such compliance is not an admission of guilt or liability, and AUSIEX is not taken to have contravened subsection 798H(1) of the Corporations Act.

Further information on market integrity infringement notices, the market integrity rules and the MDP is available in ASIC Regulatory Guide 216–*Markets Disciplinary Panel* and ASIC Regulatory Guide 225–*Markets Disciplinary Panel practices and procedures* or at <http://www.asic.gov.au> under "Regulatory Resources > Markets > Market Integrity Rules" and "Regulatory Resources > Markets > Markets Disciplinary Panel".