Markets Disciplinary Panel

20 May 2016 **MDP CIRCULAR 2016–03**

DISCIPLINARY MATTER – Credit Suisse Equities (Australia) Limited

Credit Suisse Equities (Australia) Limited (Credit Suisse) has paid a penalty of **$74,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel ("MDP").

The penalty was for Credit Suisse failing to, at all times, have in place appropriate automated price filters in relation to the use of its Automated Order Processing ("AOP") system and to ensure that such use did not interfere with the efficiency and integrity of the Market, as required.

Background and circumstances

Credit Suisse is alleged to have contravened subsection 798H(1) of the Corporations Act 2001 by reason of contravening Rule 5.6.1 of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.6.1").

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;*
> *(ii) The proper functioning of any Trading Platform; or*
> *(iii) The efficiency and integrity of any Crossing System operated by the Trading Participant.*

On the evidence before it, the MDP was satisfied that:

1) On 11 December 2014 and until 18 February 2015, inclusive ("Relevant Period"), Credit Suisse started to route 'at market' Orders on its AOP system.

2) On 18 February 2015 ("Relevant Day"), Credit Suisse submitted 167 'at market' Orders to buy 1 lot each across a basket of 167 securities ("Basket Order") via its AOP system. Between 15:12:10 and 15:47:21 on the Relevant Day, the Basket Order resulted in the execution of 160 separate 1 lot trades including the following trades ("Relevant Trades") in the respective securities ("Securities") on the ASX Market:

   (a) Trade in 1 lot of the fully paid ordinary shares of Payce Consolidated Limited ("PAY") at $7.90. The market for PAY immediately prior to the entry of this bid was $4.30/$7.90/$5.55 (Bid/Offer/Last). This bid traded immediately with a value of $7.90, and caused the price of PAY to increase by $2.35 or 42.34%. It was the only trade of the day in PAY; and

(b) Trade in 1 lot of the 1:1 CHESS Depository Interests ("CDIs") in Alcoa Inc ("AAI") at $26.86. The market for AAI immediately prior to the entry of this bid was $21.00/$26.86/$22.40 (Bid/Offer/Last). This bid traded immediately with a value of $26.86, and caused the price of AAI to increase by $4.46 or 19.91%. It was the only trade of the day in AAI.

3) At the time of the Basket Order, and the Relevant Trades which executed ("Relevant Time"), Credit Suisse had in place an AOP system with the following components:

   (a) Smart Order Router Plus ("SOR+") which was initially certified for the ASX Market and the Chi-X Market in March 2013; and

   (b) Low Latency Direct Market Access ("LLDMA") which was initially certified in July 2010 for the ASX Market; and then further certified in May 2012 to add the ASX 24 Market.

   Additionally, at the Relevant Time, Credit Suisse had in place the Global Compliance Engine ("GCE") which is its system of filters, filter parameters and limit checking. The GCE is not a certified AOP system but all Orders entered into the Credit Suisse AOP system are required to pass through the GCE before being entered into the Market.

   On the Relevant Day, the Basket Order passed through the GCE before being routed to the ASX Market via the Credit Suisse AOP system. However, Credit Suisse's GCE 'at market' filter logic ("GCE filter logic"), being the last price tolerance logic for 'at market' orders was using the following sequence to determine both the 'at market' price and the reference price to determine the percentage movement for an order to be assessed:

   (a) last traded price (of current day);
   (b) opening price (of current day);
   (c) closing price (of last day security traded); and
   (d) far touch price (i.e.Bid-Offer spread).

4) Credit Suisse's GCE filter logic resulted in inaccurate calculations for the Securities, as these were illiquid. As the Securities had not traded on the Relevant Day, there was no last traded price or opening price for the GCE filter logic to use in establishing an reference price or in its calculation of the 'at market' price. Further, the GCE filter logic did not calculate the far touch price as the 'at market' price was derived from the closing price.

5) By using the above sequence, the 'at market' price in an illiquid security was given the same price as the reference price. This calculation resulted in the GCE filter logic determining that the percentage movement in price, of the 'at market' price from the reference price was 0%, which permitted the Relevant Trades to be entered into the ASX Trading Platform without any pre-trade filter being triggered to alert Credit Suisse that submission into the ASX Market would significantly move the price of the Securities.

6) However, post-trade alerts were immediately generated after the execution of the Relevant Trades, through the SMARTSBroker third party surveillance system. Despite this, Credit Suisse first became aware of the circumstances of the Relevant Trades at approximately 16:30 on the Relevant Day, when it was contacted by ASX Compliance Pty Limited ("ASX Compliance").

7) Credit Suisse contacted ASX Market Control to request cancellation of the Relevant Trades. This request was not granted as it was outside the time limit prescribed under the ASX Operating Rulebook Procedures. ASX also did not deem the transactions invalid as defined under the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011, but as acceptable Reference Prices and allowed the Relevant Trades to stand.

8) Credit Suisse immediately disabled the ‘at market’ Order functionality on its AOP system until an amendment for the GCE filter logic was tested and implemented on 26 February 2015.

By reason of Credit Suisse’s entry of the Relevant Trades into the ASX Trading Platform which caused price movements of a 42.34% increase in PAY and a 19.91% increase in AAI respectively, Credit Suisse failed to have in place appropriate automated price filters in relation to the use of its AOP system and failed to ensure that such use did not interfere with the efficiency and integrity of the Market. Accordingly, the MDP has reasonable grounds to believe that Credit Suisse has contravened MIR 5.6.1, 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 Credit Suisse to pay for contravening subsection 798H(1) of the Corporations Act, by reason of contravening MIR 5.6.1, is $1,000,000.

Penalty under the Infringement Notice

Pursuant to subsection 798K(2) of the Corporations Act, the maximum pecuniary penalty that may be imposed by the MDP and payable by Credit Suisse under an infringement notice given for contravening subsection 798H(1) of the Corporations Act by reason of contravening MIR 5.6.1 is $600,000.

The penalty payable under this infringement notice for the alleged contravention of subsection 798H(1) of the Corporations Act and therefore the total penalty that Credit Suisse must pay to the Commonwealth is **$74,000.**

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:

- 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 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;

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

- The conduct was inadvertent on the part of Credit Suisse as Credit Suisse conducted testing of ‘at market’ Orders via its AOP system that included testing of price impact filters and Credit Suisse had a number of filters designed to limit market impact, in addition to the last price tolerance check. This approach is in accordance with ASIC Regulatory Guide 223 – *Competition in Exchange Markets* ("RG 223") as RG 223.18 states that market participant level controls can include testing, price and filters;

- However, such testing did not prevent Credit Suisse from entering the Relevant Trades into the ASX Trading Platform which caused price movements of a 42.34% increase in PAY and a 19.91% increase in AAI respectively, and accordingly, Credit Suisse failed to ensure that at all times that its AOP system had in place appropriate automated price filters which did not interfere with the efficiency and integrity of the Market;

- ASIC Regulatory Guide 241 – *Electronic Trading* ("RG 241") states at RG241.33 that "*the requirement to have appropriate automated filters is fundamental to the obligations imposed on market participants under Part 5.6.* (ASIC Market Integrity Rules (ASX Market) 2010)". Further RG 241.34 states that "*Filters and filter parameters are pre-trade controls and the principal means by which trading messages are checked to ensure they will not interfere with the efficiency and integrity of the market or the proper functioning of any trading platform*";

- RG 241.35 then provides guidance that "*Filters establish points at which trading messages are tested and by exception, action other than passing them directly into the market is taken. In practical terms, an automated filter can usually do one of four things in relation to any given trading message…*

    (a) pass the trading message into the market;
    (b) pass the trading message into the market but identify it as an exception on exception reports;
    (c) pass the trading message to a designated trading representative for review and a decision as to whether the trading message may be submitted; or
    (d) reject the trading message outright".

- Despite this guidance, Credit Suisse’s automated price filters did not result in (c) or (d) above which would have been more appropriate, but rather resulted in (a) where the Trading Messages were passed into the ASX Market despite the significant price movements which were caused in PAY and AAI;

- Notwithstanding, the Panel accepts that Credit Suisse’s automated price filters were appropriate in respect of liquid securities and not appropriate only in respect of illiquid Securities such as PAY and AAI;

- The breach was an isolated incident but was of a serious nature as the misconduct transpired over a period of two months and it had the potential to undermine public confidence in the Market;

- Credit Suisse failed to detect the breach in a timely manner despite the post-trade SMARTSBroker alerts that were immediately generated after the execution of the Relevant Trades. Credit Suisse only became aware of the breach after being informed by ASX Compliance on the Relevant Day;

- Credit Suisse contacted ASX Market Control to request cancellation of the Relevant Trades. This request was not granted as it was outside the time limit prescribed under the ASX Operating Rulebook Procedures. ASX also did not deem the transactions invalid as defined under the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011, but as acceptable Reference Prices and allowed the Relevant Trades to stand;

- Credit Suisse took steps to prevent recurrence of the breach by immediately disabling ‘at market’ Order functionality via its AOP system until an amendment for the GCE filter logic was tested and implemented on 26 February 2015;

- Credit Suisse did not derive any actual or potential benefit, as a result of the misconduct;

- Credit Suisse has three prior contraventions found against it by the MDP for non-compliance with the market integrity rules including a previous contravention of MIR 5.6.1 – MDPIN05/12 – for which Credit Suisse paid a pecuniary penalty of $52,000 and a similar contravention of MIR 5.6.3(a) – MDPIN03/13 dated 29 August 2012 – for which Credit Suisse paid a pecuniary penalty of $95,000. Credit Suisse has previously been sanctioned by the ASX Disciplinary Tribunal on six occasions since 2003. Two of these previous matters involved AOP contraventions. The MDP notes that repeat contraventions in similar or comparable matters will not be viewed favourably;

- Credit Suisse cooperated with ASIC throughout its investigation and did not dispute any material facts; and

- Credit Suisse 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

This circular adopts the definition of SMARTSBroker from the infringement notice issued to Credit Suisse in this matter.

Pursuant to subparagraphs 7.2A.15(4)(b)(i) and (ii) of the Regulations, Credit Suisse has complied with the infringement notice, such compliance is not an admission of guilt or liability, and Credit Suisse 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".