

OpenMarkets Australia Limited

Independent Compliance Expert

Summary Report

March 2017

General Use Restriction

This Independent Compliance Summary Report is prepared for use by the Australian Securities & Investments Commission ("ASIC") and OpenMarkets Australia Limited ("OpenMarkets"). This summary follows an Independent Compliance Expert Review and report performed by MIntegrity and draws on the methodology as set out in the Terms of Engagement between OpenMarkets and MIntegrity as well as the OpenMarkets Independent Compliance Expert Report.

OpenMarkets and MIntegrity acknowledge that in relation to the Expert Report, provided to ASIC and OpenMarkets, that ASIC may from time to time:

- issue a media release or statement referring to the content of the Expert Report and the Summary Report;
- publicly refer to the content of the Expert Report and Summary Report; and
- publish the Summary Report on its website.

1. INTRODUCTION

OpenMarkets, under its AFS Licence, is authorised to provide services (to retail and wholesale clients) including providing financial product advice and to deal in and make a market for specified financial products. OpenMarkets is a technology-driven stockbroker that specialises in execution-only brokerage services for trading on the Australian markets.

ASIC has identified several matters that occurred in the past 18 months, which gave rise to concerns that OpenMarkets have not complied with its obligations under the Corporations Act and the ASIC Market Integrity Rules. Specifically, that OpenMarkets may have:

- failed to have in place appropriate automated filters in relation to its AOP system;
- failed to ensure that use of its AOP system does not interfere with the efficiency and integrity of the market;
- failed to maintain the necessary organisational and technical resources to ensure that trading messages it submitted did not interfere with the efficiency and integrity of the market;
- made a bid and offer on behalf of a client in circumstance where it ought to have been aware that the client placed the order with the intention of creating a false or misleading appearance of active trading or with respect to the market for, or the price of, a product;
- failed to perform reconciliations of clients trust accounts that were accurate in all respects;
- failed to notify ASIC that a clients' trust account reconciliation has not been performed; and
- as a consequence of the above, failed to comply with its general licensee obligations.

OpenMarkets undertook to appoint an independent compliance expert for the purposes of the review, who has particular expertise in the area of market integrity and who is independent of OpenMarkets and its officers. MIntegrity has subsequently been appointed by OpenMarkets to be the Independent Compliance Expert.

This report provides a summary of the outcomes of the Independent Compliance Expert Report, dated 16 March 2017.

2. SCOPE

Objective of the Review

MIntegrity carried out the onsite component of the review between 10-11 November 2016 and 23-25 January 2017, including interviewing staff and shadowing of staff performing tasks. Further review of documents was carried out off site.

MIntegrity has undertaken an Expert Review, which, having regard to the nature, scale and complexity of the OpenMarkets' financial services business, assesses the adequacy and appropriateness of, and identifies any deficiencies in OpenMarkets':

- 1 arrangements to comply with Rules 5.2.2, 5.6.1, 5.6.3 and 5.7.1 of the ASIC Market Integrity Rules;
- 2 arrangements for handling Client Money and reconciling Client Money Accounts;
- 3 arrangements for supervising and testing adherence to, and the effectiveness of, the arrangements referred to in 1. and 2. above;
- 4 record keeping and governance arrangements that facilitate the supervision and testing referred to in paragraph 3. above; and
- 5 human and technological resources required to carry out the arrangements referred to in paragraphs 1-4 above.

Approach

Assessment areas, conduct and business practices were reviewed and assessed using the following process in relation to ASIC concerns for the Expert Report.

Table: Assessment Process

Assessment Area	Process
<p>1. Compliance measures, policies and procedures</p>	<ul style="list-style-type: none"> • The current policies and procedures that were submitted by Open Markets were reviewed. These policies and procedures were reviewed for: <ul style="list-style-type: none"> ▪ structure; ▪ readability; ▪ strength of processes; ▪ alignment with industry standards and practices; and ▪ adequacy of coverage with respect to the relevant provisions from Corporations Act 2001, ASIC Market Integrity Rules ('ASIC MIRs'), ASX Operating Rules, ASIC Regulatory Guidance, and ASX Guidance Notes ('Relevant Regulation and Regulatory Guidance'). • Missing policies and procedures required per the Relevant Regulation and Regulatory Guidance were noted • A number of updated policies have been submitted by Open Markets for second review. • Interviews with staff on-site.
<p>2. Monitoring and surveillance</p>	<ul style="list-style-type: none"> • Policies and procedures with respect to OpenMarkets' pre-trade filters and post-trade monitoring and surveillance were reviewed. • Policies and procedures were reviewed and interviews were conducted to assess the adequacy of: <ul style="list-style-type: none"> • current DMA/AOP filters are appropriate for the nature, scale and complexity of OpenMarkets' trading; • processes for, reviewing, calibrating filters and respective parameters are adequate and ongoing; and • processes for the technical operation of alert exceptions and authorisation of orders. • OpenMarkets' AOP system including key controls, namely: <ul style="list-style-type: none"> • retaining direct control over its AOP systems;

	<ul style="list-style-type: none"> • having the controls to limit, prohibit and suspend user access; and • suspending limiting and cancelling trading messages. • Current procedures and processes in part including the analysis, investigation and escalation of alerts are appropriate. • Enabled SMARTS alerts and parameters are appropriate. • Processes for the on-going review of the appropriateness of enabled alerts are adequate.
<p>3. Handling of Client Monies</p>	<ul style="list-style-type: none"> • Review of OpenMarkets written procedure manual, which detail their Trust Account Reconciliations. Focus being on: <ul style="list-style-type: none"> ○ structure; ○ applicable regulations/ rules and T&C's; ○ break scenario's and who/how/when they are resolved; ○ detailed processes which are in line with ASX Guidance Note 12; ○ escalation process; and ○ record keeping process. • Interviews with staff on-site. Focus being on, key person risk/ coverage, understanding process and key risks and observations. • Sample-based testing was conducted by MIntegrity of OpenMarkets' Trust Account Reconciliations. The testing included 10 samples randomly selected between October 2016 to January 2017. The sampling approach includes a detailed assessment which was requested by the ASX.
<p>4. Supervision and Testing</p>	<ul style="list-style-type: none"> • Policies and procedures with respect to OpenMarkets' AOP, pre-trade filters and post-trade monitoring and surveillance were reviewed. The policies and procedures were assessed for their adequacy of: <ul style="list-style-type: none"> ○ testing enabled filters as well as proposed changes; ○ procedures regarding the testing of key AOP components; and ○ supervision of escalated 'live' enquiries and investigations within the post-trade monitoring and surveillance process.

	<ul style="list-style-type: none"> • OpenMarkets' Client Money and Trust Reconciliations policies and procedures were reviewed. The policies and procedures were assessed for their adequacy of, supervision and testing process, testing frequency, sample size and approach.
<p>5. Record Keeping and Governance</p>	<ul style="list-style-type: none"> • Policies and procedures were reviewed and interviews conducted to assess whether: <ul style="list-style-type: none"> ○ the approach taken to calibrate pre-trade filters was adequately documented. In addition, whether review processes and change management procedures and their associated record keeping procedures including those for testing of changes were adequately documented and retained; ○ monitoring and surveillance procedures including records of execution of these procedures were adequately documented and retained; ○ procedures relating to other key aspects of AOP and records of execution of these procedures were adequately documented; and ○ adequacy of the process to retrieve historical data related to Client Money and Trust Reconciliations.
<p>6. Human and technological resources</p>	<p>Policies and procedures were assessed for the ability of OpenMarkets' to adequately:</p> <ul style="list-style-type: none"> ○ perform the processes as well as maintain up to date documentation regarding these processes, with the current level human and technological resources; ○ perform the procedures and retain adequate documentation with the current level of human and technological resources; and ○ identify any key person risk.

3. MAIN FINDINGS

OpenMarkets Compliance Framework

In the opinion of MIntegrity and based on best industry practice, the policies and procedures that OpenMarkets have provided to date have been found to either be incomplete and/or lacking in adequacy of coverage in terms of the level of detail considered necessary under the relevant regulations. As an overall opinion of the policies reviewed to date, OpenMarkets policies and procedures are considered deficient as at the time of the Expert Review.

At the time of this Expert Report, some policies have since been updated and provided for second review. These updated policies have incorporated the recommendations provided by MIntegrity in this Expert Report and are inclusive of the relevant regulations as well as formatted to industry standards. They are clear and precise in their understanding of their roles per the rules and obligations.

Despite a number of remaining gaps in some of the policies, the revisions completed to date are encouraging and indicative of a material shift in the culture of OpenMarkets as it relates to these policies and procedures addressing the licence conditions imposed by ASIC.

In MIntegrity's opinion, the overall Risk and Compliance Framework was found to be deficient for multiple reasons. The lack of completed policies highlighted the gaps within OpenMarkets documentation and related framework. As part of the document review, the Risk and Compliance Framework and Risk Procedures have some overlap with the defining Responsible Manager (RM)/Responsible Executive (RE) and Compliance Roles and Responsibilities. The Risk and Compliance framework needs to be revisited so as to improve conciseness of OpenMarkets' policies, monitoring, roles and duties of all involved in Compliance and Management.

From the Expert Review undertaken by MIntegrity, it is our opinion that OpenMarkets needs to establish a Risk and Compliance Committee, with an appropriate governance structure that includes a Terms of Reference to outline the function and day to day running of the committee.

OpenMarkets Pre-trade filters

OpenMarkets has enabled most 'General' and 'Pricing' pre-trade filters within Pulse and IRESS with these setting types being enabled across all accessible markets at the 'Account' and 'User group' levels.

A major component of pre-trade risk has been mitigated with key filters being enabled and filter thresholds being re-calibrated to conservative levels, a few gaps were identified that prevent OpenMarkets from having a robust pre-trade market integrity risk mitigation framework that is line with Market Participant best practice. These gaps are summarised below:

- Particular pre-trade filters that could further enhance the mitigation of disorderly markets risk were not implemented. In addition, some filter parameter values for enabled filters did not appear appropriate.
- Absence of a structured and documented procedure for the on-going review and change management of pre-trade filters including the retention of adequate documentation that demonstrates the execution of this procedure¹;

¹ It is noted that OpenMarkets' Risk Management Procedure (October 2016) includes a periodic review of 'order limits' where trader's limits are assessed against available financial resources by the Financial Account.

- Absence of a structured and documented procedure to test pre-trade filters (i.e. for filters that are currently enabled and changes that are proposed) and retention of adequate documentation;
- Absence of a consistent and documented procedure for the review of pre-trade filter exception alerts and overall authorisation of orders and their escalation by Designated Trading Representatives (DTRs).

It was observed that a shortage of human resources serves as a limitation to the ability of OpenMarkets to adopt an overall structured approach to pre-trade filter management.

Post-trade Monitoring and Surveillance

Overall the DTRs conducting the review understand and appreciate the importance of dealing with the risk of manipulative trading by clients and take appropriate steps to action and escalate matters that may arise out of the monitoring.

Despite this, a few gaps were identified that prevent OpenMarkets from having a sufficiently comprehensive post-trade monitoring program that enables the timely detection, adequate review of and escalation of potential market manipulation matters. These are summarised below:

- Several of the currently enabled alerts had been activated (and have remained activated) at their default settings since the commencement of the prescription with SMARTS. No review of the market integrity risks and ensuing alerts calibration had taken place at the outset or to date. As such, the appropriateness of generated alerts with respect to the regulatory risks is questionable;
- Absence of a structured and documented procedure in place for the analysis, investigation and escalation of post trade alerts which includes the supervision of the progress of any live investigations arising from the monitoring and surveillance and seeing them through to closure;
- Absence of an independent review procedure that assesses the appropriateness and adequacy of the first-hand alerts review and analysis, and aims to identify any missed incidents or issues;
- Absence of a periodic and on-going holistic review process that assesses changes to market integrity risks and accordingly assesses the appropriateness of enabled alerts and parameters;
- Absence of any procedure to assess the current or changes in, market integrity risks that will assist in the calibration of alerts.

It was observed that a shortage of human resources is a limitation in OpenMarkets' ability to adopt a more comprehensive approach to post-trade monitoring and surveillance.

AOP Governance

The review found that whilst the processes have been occurring with respect to other AOP related aspects, they remained either undocumented or were dispersed across other policies and procedures, making it difficult to get a complete picture of the different components of OpenMarkets' AOP system.

Client money and Client's Trust Account Reconciliation

The overall finding of the review is that OpenMarkets has demonstrated that it has a robust process in place to reconcile Clients' Trust Account accurately and in a timely manner which is in accordance with Market Integrity Rule 3.5.9 and ASX Clearing Rule 4.23.6 (this is based on the sample testing, observations and interview conducted onsite 23-25 Jan).

It was however found that OpenMarkets' Clients Trust Account reconciliation process is insufficiently documented.

4. Summary of Recommendations

No.	Recommendation
1. Compliance measures, policies and procedures	
1.1	Based on the policies that have been submitted by OpenMarkets to date, it is recommended that these policies are re-drafted in accordance with the specific guidance outlined by MIntegrity.
1.2	It is recommended that a further set of policies be drafted included those policies and procedures identified as missing. Drafting of these further policies and procedures will assist with the completion of the broader compliance framework.
1.3	It is recommended that OpenMarkets forms a Risk and Compliance Committee (RCC) that deals with all Compliance events. OpenMarkets should also formalise a structured meeting and ensure they have a standing agenda.
1.4	It is recommended that all relevant registers be drafted and submitted for review. These registers should be a live document with current issues, breaches, incidents, risks being listed.
2. Monitoring and Surveillance	
Automated pre-trade filters	
2.1	<i>MIntegrity pre-trade filter recommendations</i> Test and implement pre-trade filters and respective parameter changes recommended by MIntegrity for the two predominant order management systems – IRESS and Pulse.
2.2	<i>Periodic review of pre-trade filters breaches</i> Implementation and documentation of a structured and periodic review process of pre-trade filters and parameters. This would include the periodic review of pre-trade filter breaches (by way breaches reports) and conducting subsequent trend analysis.

2.3	<p><i>Pre-trade filters alerts authorisation</i> Implementation and documentation of a consistent authorisation process for pre-trade filter alerts and order authorisation by DTR's. This would include:</p> <ul style="list-style-type: none"> ○ An assessment process of the market integrity and other regulatory risks by a DTR before submission to the market and; ○ An escalation process for incidents related to pre-trade filter alerts, including a process for communicating appropriately with clients, the ASX and ASIC.
2.4	<p><i>Pre-trade filters change management process</i> Implementation and documentation of a structured change management procedure with respect to pre-trade filters.</p>
<p>Post-trade monitoring and surveillance</p>	
2.5	<p><i>MIntegrity post-trade alert recommendations</i> Test and accordingly implement the post-trade alerts and respective parameter changes recommended by MIntegrity.</p>
2.6	<p><i>Process for post-trade alert and trend analysis, investigation and escalation</i> Implement and document a consistent and structured process for the analysis and investigation of post-trade alerts including the escalation process for matters arising from the monitoring. Implementation and documentation of a process for conducting periodic trend analysis of post-trade alerts that tracks changes of the post-trade alerts that are generated by SMARTS</p>
2.7	<p><i>Review of all post-trade alerts</i> Implementation of a process of conducting periodic reviews of all enabled post-trade alerts and parameters which assesses the appropriateness for OpenMarkets' trading.</p>
2.8	<p><i>Independent alerts review</i> Implementation of a procedure to conduct independent reviews by Compliance of post-trade alerts commentary.</p>

3. Handling of Client Monies	
3.1	<p><i>Trust Account Reconciliation Procedures Manual</i></p> <p>It is recommended that OpenMarkets Trust Account Reconciliation procedure manual is adequately structured to include key information such as applicable regulation, key terms, the format in which the reconciliation is performed, key controls, risk assessment details, permitted withdrawals and deposits, different break scenario's and how they are cleared, the escalation process, the process for reporting client money breaches to both the ASX and ASIC and their record keeping requirements.</p>
3.2	<p><i>Reconciliation and audit trail</i></p> <p>OpenMarkets' Procedures manual and/ Trust Account Reconciliation coversheet should clearly indicate the Name of the OpenMarkets' Trust Account held at Westpac per ASX GN 12 (currently only the Account and BSB is indicated in both).</p> <p>Whilst the break description clearly identifies what the break relates to, it does not elaborate further and explain how or when the break will be cleared. In the opinion of MIntegrity, it is important to provide the "what", "when" and "how" as it will provide a good audit trail should there be any discrepancies or questions.</p>
3.3	<p><i>Independent/ Compliance Review</i></p> <p>OpenMarkets should document their compliance procedure around the independent review of the Trust Account and should also include testing frequency, sample size and approach.</p>
3.4	<p><i>Key person risk/ coverage</i></p> <p>Additional coverage should be put in place for unplanned absences to prevent any issues with completing Reconciliations both accurately and timely. It is recommended that an additional resource is available or recruited on an ongoing short term contractual basis to assist in improving OpenMarkets' written procedures and assist in developing a risk and compliance framework. OpenMarkets has coverage on non-settlement days (generally State only holidays) and its recommended that the Reconciliations are performed every working day except where the ASX is closed (National holiday) to help identify and address any reconciliation issues timely.</p>

4. Supervision and Testing	
	Testing –Pre-trade filters & AOP
4.1	<p>Testing of enabled pre-trade filters & proposed changes Periodic testing of all currently enabled filters as well as proposed changes (in accordance with a testing plan) to ensure they operate as expected followed by subsequent sign off by OpenMarkets management.</p>
4.2	<p>Broader testing of AOP key components Implementation and documentation of a structured procedure to conduct on-going periodic testing (in accordance with a test plan) of the key OpenMarkets AOP system components. This testing is to assist OpenMarkets to conduct its Annual AOP review.</p>
	Post-trade monitoring and surveillance
4.3	<p>Supervision of issues and incidents Progress of any live investigations, matters or incidents identified through the post-trade monitoring to be discussed at the Risk and Compliance Committee.</p>
	Client Monies
4.4	<p>Independent/Compliance Review OpenMarkets should document their compliance procedure around the independent review of the Trust Account and should also include testing frequency, sample size and approach.</p>
5. Record Keeping and Governance	
5.1	<p>Pre-trade filters policy Drafting of a 'Pre-trade filters policy' that outlines the approach taken to calibrating OpenMarkets' automated pre-trade filters, as well as the on-going review and change management of pre-trade.</p>

	Monitoring and surveillance
5.2	Re-drafting of the Monitoring and Surveillance procedure to clearly outline processes (including any record keeping requirements) occurring as part of the post-trade monitoring and surveillance program.
5.3	AOP Control Document The drafting of an overarching document that consolidates and centralises all the main provisions of AOP related policies and procedures that would serve as the main document governing AOP policy.
	Client Monies
5.4	Record Keeping process and timeline A timeline should be put in place for implementation of their record keeping processes. In 2017 OpenMarkets plan to maintain soft copies of their reconciliations by scanning these to a central location/ drive for easy access. The Record Keeping process should be documented to ensure that historical reconciliations or any audit item can be easily located in the future.
6. Human and Technological Resources	
6.1	In light of all the above recommendations and OpenMarkets adequate implementation, execution and generation of respective documentation it is recommended that OpenMarkets has: <ul style="list-style-type: none"> • Two full time Compliance personnel; • One contractual human resource is available or recruited on a short term ongoing contractual basis to assist in improving OpenMarkets written procedures and assist in developing a risk and compliance framework.

DECLARATION

MIntegrity has made all inquiries in connection with its assessment that MIntegrity believes are desirable and appropriate taking into account the requirements of the ASIC AFS Licence conditions imposed on OpenMarkets.

To MIntegrity's knowledge, no material information which would be regarded as relevant to this assessment has been withheld from MIntegrity by OpenMarkets or any relevant third-party service provider.

DISCLAIMER

MIntegrity notes that all potential points of non-compliance related to the business of OpenMarkets may not have been identified during the Review. This is due to the existence of limitations inherent in reviewing the compliance framework of any AFS License holder, including the inconclusive nature of sample employee interviews or testing, which may not identify all instances of potential misconduct or other non-compliance with relevant regulatory obligations.

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