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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Regulations 2001* administered by ASIC may have a right of review or may be entitled to have the infringement notice withdrawn.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

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PART 7.2A OF THE CORPORATIONS REGULATIONS 2001 INFRINGEMENT NOTICE

To:

Merrill Lynch Equities (Australia) Limited
ACN 006 276 795
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 ("Merrill Lynch") under regulation 7.2A.04 of the Corporations Regulations 2001 ("the Regulations"). To comply with this notice Merrill Lynch must:

Pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **\$120,000.**

This infringement notice is given on 2 April 2013.

The unique code for this notice as required by paragraph 7.2A.06(b) of the Regulations is MDP3659/12.

Alleged contravention and penalty

Merrill Lynch 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* ("the 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 Rule 5.6.3(a) of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.6.3(a)", which provides:

"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 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 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:

"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).

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

"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.

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

1. From 1 August 2010 to 24 May 2011 Merrill Lynch was a Trading Participant in the Market.
2. On 24 May 2011, at 12:12:54, Merrill Lynch entered a sell Order for 50 million ordinary shares on deferred settlement in Future Corporation Australia Limited, having ASX Code ("FUTDA"), at a price of \$0.002 ("the Relevant Order") into the Trading Platform.
3. The Relevant Order was entered by Merrill Lynch on behalf of Merrill Lynch Global Wealth & Investment Management ("GWIM") in Singapore.
4. GWIM entered the Relevant Order manually into a Merrill Lynch AOP system called Fidessa.
5. As a result of GWIM being unaware of a recent 1:10 share reconstruction in FUTDA, GWIM entered the Relevant Order at \$0.002 instead of \$0.02.
6. The Relevant Order was automatically routed to the Market by Fidessa despite it being 13 price steps and 86.7 percent lower than the priority Bid in the Market.
7. The Relevant Order traded in 13 Market Transactions at prices from \$0.015 to \$0.002 inclusive, resulting in an 86.7% decrease in the price of FUTDA. Eleven of the Market Transactions were subsequently cancelled.
8. The entry of the Relevant Order into the Trading Platform on 24 May 2011 resulted in an 86.7% decrease in the price of FUTDA. The subsequent cancellation of 11 of Merrill Lynch's 13 Market Transactions in FUTDA, involved a total of five counterparties.
9. In March 2009, unknown to Merrill Lynch, changes were made to its Fidessa AOP system to permit manually entered Orders by GWIM, which met certain parameters, to be automatically routed to the Market without review by Merrill Lynch's Trading Desk by a DTR, nor subject to any price tolerance or price step filters or other checks.

The MDP found it had reason to believe that Merrill Lynch's failure to ensure that its Fidessa AOP system had organisational and technical resources, including having appropriate automated filters, filter parameters and processes to record any changes to the filters or filter parameters in place from 1 August 2010 to 24 May 2011, to enable Trading Messages to be submitted into the Trading Platform; interfered with the efficiency and integrity of the Market and the proper functioning of the Trading Platform, and failed to comply with MIR 5.6.3(a), and thereby contravened subsection 798H(1) of the Act.

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 5.6.3(a), is \$1,000,000. The maximum penalty that may be payable under an infringement notice for an alleged contravention of that rule 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 Merrill Lynch must pay to the Commonwealth is \$120,000.

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 and noted in particular the following:

- That the remedies applied should promote market integrity and confident and informed participation of investors in financial markets;
- That the remedies should act as a deterrent to any future misconduct by the subject person and should also act as a general deterrent to others from engaging in the same or similar conduct;
- That the subject person's history of compliance will also be considered and greater sanctions will be applied for repeat contraventions in similar or comparable matters;
- MIR 5.6.3(a) imposes mandatory obligations and is aimed at (among other things) promoting confidence in the integrity of the Market by ensuring that AOP systems have the appropriate filters, filter parameters and processes to record any changes to the filters or filter parameters. This means, a Market Participant which uses AOP systems must ensure that it has in place organisational and technical resources to record any changes to the filters, filter parameters or processes of the AOP systems it has put in place. If at any time the filters or filter parameters are modified or altered in any way, it is unacceptable for Market Participants to not be in a position to record such changes.
- Accordingly, it follows that a Market Participant is therefore obliged at all times to have and maintain active control over its automated filters, filter parameters and processes. This includes being aware of authorisations, and to record any changes made to its AOP systems, in order to ensure it is in a position to comply with MIR 5.6.3(a);
- It is not acceptable to modify or otherwise make changes to the filters, filter parameters and processes of a Market Participant's AOP system, (by which Orders can be placed electronically and directly onto the Market), without the knowledge, authorisation and recording of such changes by the Market Participant concerned;
- AOP filters, filter parameters and processes are essential components of an electronic direct market access trading system used by clients of Market Participants. AOP filters are in place to ensure Trading Messages are submitted onto the Trading Platform without interfering with the efficiency and integrity of the Market or the proper functioning of the Trading Platform;
- The failure to ensure that AOP systems or electronic direct market access trading systems have these requisite safeguards, risks undermining market integrity because it poses a risk to public confidence in the Market;

- Merrill Lynch failed to ensure that its organisational and technical resources were such that AOP filter changes to its Fidessa AOP system could only be made with Merrill Lynch's knowledge and authorisation, and that any unauthorised changes were promptly detected, rectified and prevented;
- Merrill Lynch's failure to ensure that each of these elements were in place had the potential to damage the efficiency and integrity of the Market and cause loss to third parties;
- The unauthorised changes made in March 2009 to the Merrill Lynch Fidessa AOP system, were not detected by Merrill Lynch until after the trading in FUTDA on 24 May 2011;
- Accordingly, for a significant period of time, Merrill Lynch failed to have the relevant organisational and technical resources in place, which meant that a change could and was made to the filter parameters of its AOP Fidessa system, which was outside its knowledge and control;
- The contravention which is the subject of this notice occurred over an unacceptable period of time, from 1 August 2010 (when the ASIC market integrity rules commenced) to 24 May 2011;
- Merrill Lynch's poor compliance history including Merrill Lynch's failure to address a comparable contravention, referred to as *Contravention 1* by the ASX Disciplinary Tribunal in ASX Disciplinary Circular 445/10 ("ASX DC 445/10") dated 9 December 2010, where Merrill Lynch was put on notice to ensure against similar misconduct, is notable. The MDP takes into account this previous assurance not having been met and deems it significant, particularly in light of the Tribunal's specific warning in ASX DC 455/10 – "*The Tribunal emphasises the importance of MLEAL ensuring that it has appropriate measures in place to prevent any further misconduct*";
- The ASX Disciplinary Tribunal in ASX DC 445/10 also noted that Merrill Lynch had taken significant remedial action to prevent a recurrence of such contravention through a range of measures, including upgrading the corporate governance, risk management, supervision and compliance structures of Merrill Lynch ("the Project"). However, the Project failed to prevent the matter that is the subject of this notice;
- Merrill Lynch has taken further remedial action to prevent a recurrence of this incident, including making organisational changes so that any changes to a Merrill Lynch AOP system are now recorded and made with its knowledge and authorisation;
- 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; and
- (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; and
- (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; and
- (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: 2 April 2013