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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Regulations 2001* administered by ASIC may have a right of review or may be entitled to have the infringement notice withdrawn.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
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 **\$65,000.**

This infringement notice is given on 9 May 2014.

The unique code for this notice as required by paragraph 7.2A.06(b) of the Regulations is MDP11789/13.

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 those 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 Rule 5.9.1 of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.9.1") which 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 8 August 2011, at approximately 11:24am, a Merrill Lynch Designated Trading Representative or DTR ("Merrill Lynch DTR") entered an Order into the ASX Trading Platform for the sale of 6,985 of a Tailor-Made Combination ("RIO TMC"), at a net price of one cent each ("Relevant Order"). The Relevant Order, in effect, comprised an instruction to:
 - (a) sell 6,985 units being 698,500 ordinary shares in RIO Tinto Limited ACN 004 458 404 ("RIO"); and
 - (b) buy 6,985 RIO \$77.00 call option contracts that expired on 27 October 2011 ("RIOWV7").
- 2) The Relevant Order was erroneous in that the Merrill Lynch DTR had intended to enter an Order to sell one RIO TMC, comprising an instruction to sell one unit (comprising a sell of 100 RIO) and to buy one RIOWV7, at a net price of \$69.85.
- 3) Immediately prior to the entry of the Relevant Order into the ASX Trading Platform, the market for RIO was as follows:
 - (a) the Bid/ask/last traded price - \$71.40/\$71.41/\$71.42; and
 - (b) the Bid schedule for RIO contained Bids for a total of about 211,400 RIO at prices between \$71.40 and \$50.00.
- 4) The net price at which the Relevant Order was entered did not accurately reflect material information relevant to and genuine supply for, the relevant component product, RIO.
- 5) The Relevant Order resulted in the generation of derived Orders ("RIO Sell Orders") which were entered into the market for RIO at prices down to \$1.43.
- 6) The Relevant Order executed on the ASX Trading Platform between approximately 11:24am and 11:26am as follows:
 - (a) against opposing Orders for the RIO TMC in the Tailor-Made Combination ("TMC") market; and
 - (b) by the matching of derived Orders, against opposing Orders in the markets for the components, RIO and RIOWV7.
- 7) The ASX trade matching engine (the algorithm used for the purpose of TMC Orders) facilitated the execution process by allowing for the entry of the Relevant Order, the creation of derived Orders and the subsequent matching events.
- 8) The execution of the Relevant Order resulted in 337 Market Transactions for the sale of a total of 561,700 RIO at prices from \$71.40 to \$1.43. The 337 Market Transactions comprised:
 - (a) ten Market Transactions which executed in the TMC market for the sale of 150,000 RIO at prices from \$36.44 to \$26.63;

- (b) one hundred and sixty five Market Transactions for the sale of 141,000 RIO which executed in the market for RIO at prices from \$71.40 to \$70.20; and
 - (c) one hundred and sixty two Market Transactions for the sale of 270,600 RIO which executed at prices from \$1.91 to \$1.43 through trading with Bids in the market for RIO, although not necessarily in price/time priority ("Relevant Transactions").
- 9) The contravention relates only to the Relevant Transactions (as defined in paragraph 8(c) above).
- 10) But for the entry of the Relevant Order, the RIO Sell Orders would not have been generated and would not have been able to trade in the market for RIO at prices between \$1.91 and \$1.43, as described above.
- 11) The execution of the Relevant Order resulted in a significant decrease in the price of RIO which did not accurately reflect material information relevant to the price of RIO in that:
- (a) the price of RIO decreased by \$69.99 or 98 percent below the last price at which RIO had traded immediately prior to the entry of the Relevant Order; and
 - (b) the market for RIO varied significantly having regard to the market for RIO which existed immediately before and after the Relevant Order.
- 12) The error was identified by Merrill Lynch's trading desk and Merrill Lynch compliance monitoring. At approximately 11:36am, Merrill Lynch contacted ASX, advised that the Relevant Order had been entered in error and requested that the error be referred to the ASX Dispute Governors Committee ("DGC"). The DGC subsequently convened and recommended that all Market Transactions in RIO at \$64.35 or below be cancelled.
- 13) ASX directed the cancellation of all Market Transactions in RIO which had been executed between 11:24am and 11:27am, at or below \$64.35. One hundred and seventy two of the 337 Market Transactions, including the 10 Market Transactions executed against opposing Orders for RIO TMC and each of the 162 Relevant Transactions, were cancelled pursuant to ASX's direction. A further 28 Market Transactions for RIO, which executed at prices above \$64.35, were cancelled with counterparty agreement.

By reason of Merrill Lynch's entry of the Relevant Order into the ASX Trading Platform on 8 August 2011, which resulted in the market for RIO not being both fair and orderly, the MDP has reasonable grounds to believe that Merrill Lynch has contravened MIR 5.9.1 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 5.9.1, is \$1,000,000.

Pursuant to subsection 798K(2) of the Act, the maximum pecuniary penalty that may be imposed by the MDP and payable by Merrill Lynch under an infringement notice given for contravening subsection 798H(1) of the Act by reason of allegedly contravening MIR 5.9.1, 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 **\$65,000**.

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, including ASIC Regulatory Guide 216—*Markets Disciplinary Panel*, and noted in particular the following:

- MIR 5.9.1 is 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;
- The misconduct had the potential to cause widespread detriment, impact public confidence, and damage the reputation and integrity of the market, as the entry of the Relevant Order into the ASX Trading Platform caused the price of RIO to decrease from the last traded price of \$71.42 to \$1.43, being a \$69.99 or 98% decrease in the price of RIO. In this regard, the MDP noted the market prominence of RIO, not only within the ASX Market, but also other secondary markets;
- The misconduct was inadvertent on the part of Merrill Lynch as the Merrill Lynch DTR failed to properly exercise his functions to the requisite high standard when he incorrectly transposed price and volume, before submitting the Relevant Order into the ASX Trading Platform;
- In this matter the Merrill Lynch DTR, after keying the Relevant Order into an ASX Trader Workstation did not receive any price variation warning messages or alerts prior to the Relevant Order being submitted into the ASX Trading Platform. Notwithstanding this, the MDP reiterated that an important aspect of the role of the DTR is to pay proper attention and diligence to prevent the entry of Orders into the Trading Platform that could result in a market that is not both fair and orderly. This is a critical measure in maintaining the integrity of a market;
- Merrill Lynch did not derive any actual or potential benefit from the breach, although the breach had the potential to cause detriment to counterparties whose transactions were cancelled;
- The breach was isolated;
- Merrill Lynch promptly identified the error and took action to remedy the breach, including following ASX Operating Rules Procedures to cancel the Relevant

Transactions. As a result, the 162 Relevant Transactions were cancelled pursuant to ASX direction;

- Merrill Lynch took the following remedial measures to prevent recurrence of the breach:
 - stopped trading in stock/option TMCs until a review of the controls in place was undertaken;
 - undertook a review of the controls available on the ASX Trading Platform and other possible controls in relation to TMCs;
 - following the above review, an enhanced procedure for the placement of stock/option TMCs was implemented, requiring an additional level of oversight and approval;
 - provided training on the general market integrity rule obligations and specifically on the newly implemented procedure to all staff involved in the placement of TMCs; and
 - actively engaged with ASX in relation to enhancements to filter capabilities in relation to the placement of TMCs.
- Merrill Lynch had one prior contravention found against it by the MDP for non-compliance with the market integrity rules;
- Merrill Lynch had 10 disciplinary sanctions recorded against it by the ASX Disciplinary Tribunal since 2005. This included Merrill Lynch having previously been sanctioned by the ASX Disciplinary Tribunal regarding the predecessor rule to MIR 5.9.1 in ASX Circulars 446/10 – dated 9 December 2010 and 117/10 – dated 6 April 2010;
- The MDP had regard to Merrill Lynch's compliance history and noted that notwithstanding the inadvertent human error in this matter, it could not overlook that this followed a series of compliance failures. The MDP also noted its previous comments in MDP Infringement Notice No. MDP07/13 – dated 22 October 2013, "...that, repeat contraventions in similar or comparable matters will not be viewed favourably";
- 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

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.

Dated: 9 May 2014

Appendix – Defined Terms

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

"D'TR" means a Representative of the Trading Participant who has been authorised to submit Trading Messages to the Trading Platform on behalf of the Trading Participant.

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

"Market Operating Rules" means the Operating Rules of the Market, other than the Market Listing Rules.

"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....

"Tailor-Made Combination" has the meaning given by the Market Operating Rules.

"Trader Workstation" means a personal computer with Trader Workstation Software installed.

"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 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.