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31 May 2013

MDP CIRCULAR 2013-02

### **DISCIPLINARY MATTER – Merrill Lynch Equities (Australia) Limited**

Merrill Lynch Equities (Australia) Limited (“Merrill Lynch”) has paid a penalty of **\$120,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel (“MDP”) for not ensuring that its Automated Order Processing (“AOP”) system had in place at all times, as required, organisational and technical resources, including having appropriate automated filters, filter parameters and processes to record any changes to the filters or filter parameters; and for not ensuring that the use of such system, which enables Trading Messages to be submitted into the ASX Trading Platform, did not interfere with the efficiency and integrity of the Market or the proper functioning of the ASX Trading Platform.

#### **Background and circumstances**

Merrill Lynch is alleged to have contravened subsection 798H(1) of the *Corporations Act 2001* (“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.”*

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

1. From 1 August 2010 to 24 May 2011 Merrill Lynch was a Trading Participant in the ASX 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 (“Relevant Order”) into the ASX 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 ASX 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 ASX 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 ASX 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.

Accordingly, as a result of Merrill Lynch's failure to ensure that its Fidessa AOP system had in place adequate organisational and technical resources between 1 August 2010 to 24 May 2011, which resulted in the Relevant Order causing an 86.7% price decrease in FUTDA on 24 May 2011, the MDP had reasonable grounds to believe that Merrill Lynch contravened 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**.

### **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:

- 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 445/10 – “*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.

### **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 sub-paragraph 7.2A.15(4)(b)(i) and (ii) of the Regulations, Merrill Lynch has complied with the infringement notice, such compliance is not an admission of guilt or liability, and Merrill Lynch is not taken to have contravened subsection 798H(1) of the Act.

Further information on market integrity infringement notices, the market integrity rules or 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 “markets–supervision”, “markets–market integrity rules” and “Markets Disciplinary Panel”.