

DISCIPLINARY MATTER – Instinet Australia Pty Limited

Instinet Australia Pty Limited (“Instinet”) has paid a penalty of **\$130,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel (“MDP”). The penalty was for not having in place at all times, as required, an appropriate automated filter in its Automated Order Processing (“AOP”) system to address the issue of wash trades or trades where there is no change in beneficial ownership (“NCBO”).

Background and circumstances

Instinet is alleged to have contravened subsection 798H(1) of the *Corporations Act 2001* (“Act”) by reason of contravening Rule 5.6.1(a) of the ASIC Market Integrity Rules (ASX Market) 2010 (“MIR 5.6.1(a)”), which 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;”

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

1. From 22 October 2010 to 26 November 2010 (inclusive), Instinet sent Orders on behalf of a client through a Co-Location AOP system, which would either allow the Orders to be submitted onto the Trading Platform or reject them according to the following four filters:
 - Gross Exposure for a Client;
 - Individual Maximum Order Limit;
 - Percentage from Last Traded Price; and
 - Out of Hours Order Placement.
2. From 22 October 2010 to 28 October 2010, Instinet executed 17 Crossings on behalf of the client through the Co-Location AOP system as follows:
 - 6 Crossings in ordinary shares in Kingsgate Consolidated Limited, having ASX code “KCN”;
 - 3 Crossings in units in SPDR S&P/ASX 200 Fund, having ASX code “STW”; and
 - 8 Crossings in ordinary shares in Dominion Mining Limited, having ASX code “DOM”.
3. From 29 October 2010 to 26 November 2010 (“Relevant Period”), Instinet executed a further 672 Crossings on behalf of the client through the Co-Location AOP system as follows:

- 478 Crossings in DOM;
 - 50 Crossings in KCN; and
 - 144 Crossings in various other securities.
4. The Crossings ranged in value from \$2.97 to \$215,696.30.
 5. The Crossings all had the same buy/sell trade cross reference of “COL2”, being the trade cross reference used by Instinet to identify trades executed on the account of their client.
 6. The Crossings involved no change of beneficial ownership as the client of Instinet was trading on behalf of their own account.
 7. The orders submitted by the client that resulted in the Crossings, were not rejected as a result of triggering any one of the four Co-Location AOP filters.
 8. As a high frequency trader and given its specific trading strategy, the client represented an increased risk of transacting accidental crossings in the market.
 9. During the Relevant Period, Instinet created SMARTS Monitoring File Notes, which, amongst other things, detailed the total number of possible NCBO trades.
 10. The 26 SMARTS Monitoring File Notes established that during the Relevant Period there were 860 possible NCBO trades, with the 672 Crossings during that period included in the 860 possibilities.
 11. None of the Crossings were cancelled, nor reported to the ASX requesting cancellation.

The MDP considers that in these circumstances at least from the beginning of the Relevant Period, Instinet was required to give consideration to their regulatory obligation and should have applied an appropriate filter to address the issue that is being a wash trade or NCBO filter. By reason of the entry of 672 Crossings during the Relevant Period, via the Co-Location AOP system, the MDP found it had reason to believe that Instinet failed to have appropriate automated filters and thereby failed to comply with MIR 5.6.1(a).

As a result of failing to comply with MIR 5.6.1(a), which requires that appropriate automated filters must be used at all times when using AOP systems, Instinet thereby contravened subsection 798H(1) of the Act which requires compliance with the market integrity rules.

Maximum pecuniary penalty that a Court could order

The maximum pecuniary penalty that a Court could order Instinet to pay for contravening subsection 798H(1) of the Act by reason of contravening MIR 5.6.1(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 Instinet must pay to the Commonwealth is **\$130,000**.

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:

- The serious nature of the breach;
- MIR 5.6.1 is aimed at ensuring a fair, orderly and transparent trading system, with a strict obligation imposed on Market Participants which use systems for AOP, to ensure that at all times they have appropriate automated filters and that their AOP systems do not interfere with the efficiency and integrity of the Market or the proper functioning of the Trading Platform;
- MIR 5.6.1(a) imposes a mandatory obligation to have appropriate filters as indicated by use of the word “must”;
- Instinet’s failure to ensure that it had appropriate automated filters in place had the potential to damage the efficiency and integrity of the market. The failure to ensure that AOP systems or direct market access systems have these requisite safeguards, risks undermining public confidence in the market;
- The trades with no change in beneficial ownership did not represent genuine, bona fide trades in the Market, but gave the appearance that they were. As such they interfered with the integrity of the Market and proper functioning of the ASX Trading Platform;
- From at least 29 October 2010, Instinet was aware of Crossings entering into the Market without Instinet having an appropriate filter;
- Instinet was on notice of the NCBO Crossings due to its SMARTS daily post trade reports that reported NCBO trades;
- Instinet failed to enter the SMARTS NCBO alerts in its compliance register or act on them;
- In the circumstances, Instinet ought to have identified the regulatory risk associated with the Crossings on the basis of the SMARTS reports and escalated the issue - including immediately requesting the ASX cancel the NCBO trades;
- The Crossings during the Relevant Period did not represent genuine trades on the Market and in the view of the Panel should have been reported to the ASX in a timely manner and cancellation of them sought;

- From at least 29 October 2010, Instinet was required to give consideration to its regulatory obligation and should have applied an appropriate automated filter to address the issue of the Crossings;
- In the alternative, Instinet was required immediately to deny the client continued access to its Co-Location AOP system until the appropriate automated filter was put in place to prevent the Crossings continuing to occur;
- While the breach involved one contravention, it consisted not of an isolated incident, but involved 672 trades occurring over 21 days. Instinet's conduct continued for an unacceptable and extended period of time in the circumstances;
- The MDP noted that during the Relevant Period Instinet did not have effective internal procedures in place to ensure compliance with the mandatory obligations of MIR 5.6.1(a);
- In the MDP's view, these factors were indicative of a serious pattern of non-compliance by Instinet, notwithstanding Instinet's misguided belief that it was entitled to regard the NCBO Crossings as "testing" by the client.
- Instinet did not consider the 672 NCBO crossings that occurred from 29 October 2010 to 26 November 2010 to be a breach, so therefore did not self-report the breach to ASIC;
- Notwithstanding the mistaken belief of Instinet that there was not a breach, Instinet was required to self-report the 672 NCBO crossings to ASIC, and failed to do so;
- Instinet did not take timely action to rectify the breach. It was not until sometime after 28 September 2012 that Instinet included an NCBO filter in its Co-Location AOP system;
- The Panel found that in all the circumstances of the matter, Instinet's misconduct during the Relevant Period, was careless and irresponsible in the context of its regulatory obligations;
- In particular, the Panel found that in all the circumstances of the matter, Instinet's misconduct constituted an unacceptable serious lack of judgment and proper reasonable regard to its mandatory obligation to have in place an appropriate filter during the Relevant Period;
- Instinet has been trading in Australia since February 2010 with no recorded history of non-compliance with the market integrity rules or ASX Market Rules; and
- Instinet co-operated with ASIC throughout its investigation.

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, Instinet has complied with the infringement notice, such compliance is not an admission of guilt or liability, and Instinet 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”.