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21 January 2014

MDP CIRCULAR 2014-01

### **DISCIPLINARY MATTER – Citigroup Global Markets Australia Pty Limited**

Citigroup Global Markets Australia Pty Limited ("Citigroup") has paid a penalty of **\$40,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel ("MDP"). The penalty was for failing to demonstrate prudent risk management procedures by not setting and documenting appropriate maximum price change limits, as required.

#### **Background and circumstances**

Citigroup is alleged to have contravened subsection 798H(1) of the Act by reason of contravening Rule 2.2.1(1)(b) of the ASIC Market Integrity Rules (ASX 24 Market) 2010 ("MIR 2.2.1(1)(b)"), which provides:

*"(1) Limits:*

*A Market Participant must demonstrate prudent risk management procedures, including, but not limited to:*

*(b) set and document maximum price change limits;"*

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

- 1) On 23 November 2011 at approximately 16:40:00, the ASX published the Daily Settlement Price ("DSP") for the January 2013 ASX 30 Day Interbank Cash Rate Futures Contract ("IBF3"), being 97.070.
- 2) At 17:26:32, a Client of Citigroup ("Citigroup Client") entered an Order to buy one December 2011/ January 2013 ASX 30 Day Interbank Cash Rate Futures Contract spread ("IBZ1F3") with a price differential of -15.0 points ("Initial Order") via Citigroup's Direct Market Access ("DMA") system. Despite the price of the Initial Order being of significant variation away from the prior IBF3 DSP of 97.070, the Initial Order was able to enter into the ASX Trading Platform as Citigroup's Automated Order Processing ("AOP") system (supplied by a third party software vendor) had a maximum price change limit set at the maximum of 999.9 basis points for ASX 30 Day Interbank Cash Rate Futures Contracts.
- 3) At 17:26:44 the Citigroup Client entered another Order via DMA, being an Order modifying the Initial Order by changing the price differential from -15.0 to -13.0 points for the one IBZ1F3 ("Amended Order"). The Amended Order created an implied offer of 95.900 for one IBF3.

- 4) At 17:26:57 the Citigroup Client entered yet another Order via DMA, this time being an Order modifying the Amended Order by increasing the volume from one to 200 IBZ1F3 at -13.0 points ("Relevant Order"). The Relevant Order created an implied offer of 95.900 for 200 IBF3.
- 5) At 17:31:44 another Market Participant entered an Order into the Trading Platform to buy 200 IBF3 at 95.900 which transacted with the Relevant Order resulting in the Trading of the December 2011 ASX 30 Day Interbank Cash Rate Futures Contract ("IBZ1") and IBF3, as follows:

Contract	Deal No.	Buyer	Seller	Price	Volume
IBZ1	281	Citigroup		95.770	200
IBF3	282		Citigroup	95.900	200

- 6) Deal 282 ("Relevant Deal") was the first Trade in IBF3 since publication of the DSP of 97.070. The Relevant Deal Traded at 95.900, being 117 points lower than the prior IBF3 DSP.
- 7) The Traded price of 95.900 placed the Relevant Deal in the Mandatory Cancellation Range as per rule [3210] of the ASX 24 Operating Rules.
- 8) On 24 November 2011, between approximately 08:00:00 and 08:30:00 during a review, Citigroup became aware of the Relevant Deal.
- 9) Between approximately 08:30:00 and 09:00:00, Citigroup contacted the ASX to request cancellation of the Relevant Deal. The ASX denied the request. At approximately 12:37:00, Citigroup sent a second request to the ASX requesting cancellation of the Relevant Deal which was again denied.
- 10) At approximately 17:10:00, during a phone call with ASX 24 representatives, Citigroup was advised that the ASX would not cancel the Relevant Deal under either of the following:
  - rule [3210] of the ASX 24 Operating Rules and procedure 3210 of the ASX 24 Operating Rulebook Procedures which at the time relevantly stated:

*"The Exchange will not enact the Exchange Cancellation of Erroneous Trades Rule if more than 60 minutes has elapsed since the time of trade execution or 10 minutes has elapsed since the close of trading on the relevant Trading Day, whichever is sooner."*
  - rule [3100] of the ASX 24 Operating Rules which relevantly states:

*"The Exchange may take any action it considers necessary to ensure that a market for one or more Products is fair, orderly and transparent, including, without limitation...cancelling or amending any Transaction."*

By reason of Citigroup's failure to demonstrate prudent risk management procedures by not setting and documenting maximum price change limits on 23 November 2011, the MDP had reasonable grounds to believe that Citigroup had contravened MIR 2.2.1(1)(b) and 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 Citigroup to pay for contravening subsection 798H(1) of the Act by reason of contravening MIR 2.2.1(1)(b), is \$1,000,000.

The maximum pecuniary penalty that may be payable by Citigroup under an infringement notice given pursuant to subsection 798K(2) of the Act, is \$600,000.

## **Penalty under the Infringement Notice**

The penalty payable under the infringement notice for the alleged contravention of subsection 798H(1) of the Act and therefore the total penalty that Citigroup must pay to the Commonwealth, is **\$40,000**.

## **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:

- MIR 2.2.1(1)(b) is aimed at ensuring that all Market Participants must at all times have and maintain appropriate controls to ensure that Orders submitted by them into a Trading Platform do not interfere with the integrity of the market;
- Market Participants are specifically required to set and document appropriate pre-determined Order and/or position limits on each of their Client Accounts. Setting limits at a maximum setting of 999.9 basis points is inadequate and does not demonstrate prudent risk management procedures as a Market Participant with DMA Clients;
- The breach had the potential to damage the reputation and integrity of the Market. Citigroup's maximum price change limit of 999.9 basis points for ASX 30 Day Interbank Cash Rate Futures Contracts was inadequate. It failed to prevent the Relevant Order from entering into the Trading Platform resulting in the Relevant Deal Trading at 95.900, being at a price 117 points lower than the prior IBF3 DSP of 97.070 and representing a value approximately \$600,000 away from fair value;
- The breach was careless on the part of Citigroup as it neglected to set and document maximum price change limits for the Citigroup Client, instead relying on its AOP system which had an inadequate maximum price change limit set at the maximum of 999.9 basis points for ASX 30 Day Interbank Cash Rate Futures Contracts;
- Citigroup's AOP system did not have the technological capability to host price movement filters as it only permitted the coding of a single hard price limit. Notwithstanding this, a Market Participant must demonstrate prudent risk management procedures by setting and documenting maximum price change limits. An inadequate maximum price change limit of 999.9 basis points for ASX 30 Day Interbank Cash Rate Futures Contracts does not represent prudent risk management procedure;
- The MDP emphasised that Market Participants ought to pay proper care and diligence in the setting and documentation of limits. This is a critical measure in maintaining the integrity of a market;

- Citigroup did not derive any actual or potential benefit from the breach;
- Citigroup requested cancellation of the Relevant Deal from the ASX on three separate occasions on 24 November 2011, but was denied on the basis of rules [3100] and [3210] of the ASX 24 Operating Rules at the relevant time;
- Citigroup informed ASIC of the breach at 5.30pm on 24 November 2011 and requested assistance in working with the ASX to cancel the Relevant Deal;
- Citigroup took the following remedial measures to prevent recurrence of the breach:
  - Immediately updated its AOP system's maximum price change limit setting for ASX 30 Day Interbank Cash Rate Futures Contracts;
  - Implemented through stages during the course of 2012, a new AOP system (supplied by another third party software vendor) incorporating a risk management tool with functionality for tailored volume and price limits;
  - Enhanced its Client setup manual in relation to the setting and review of risk management tools;
  - Enhanced its futures compliance manual in relation to the cancellation process;
  - Trained its futures sales and electronic execution teams on a number of issues including risk management setup and cancellation process; and
  - Undertook a review of automated trading.
- Citigroup had no prior contraventions found against it by the MDP for non-compliance with the ASIC Market Integrity Rules (ASX 24 Market) 2010, but has been sanctioned by the ASX Disciplinary Tribunal on one occasion relating to non-compliance with the Operating Rules of the Sydney Futures Exchange (ASX Circular 080/10 dated 3 March 2010);
- Citigroup had one prior contravention found against it by the MDP for non-compliance with the ASIC Market Integrity Rules (ASX Market) 2010 (MDP Circular 2012-3 dated 27 August 2012) and has been sanctioned by the ASX Disciplinary Tribunal on two occasions relating to non-compliance with the ASX Market Rules (ASX Circular 477/09 dated 23 December 2009 and ASX Circular 076/10 dated 1 March 2010);
- Citigroup co-operated with ASIC throughout its investigation and did not dispute any material facts; and
- Citigroup 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, Citigroup has complied with the infringement notice, such compliance is not an admission of guilt or liability, and Citigroup 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".