

DISCIPLINARY MATTER – FC Stone Australia Pty Ltd

FC Stone Australia Pty Ltd ("FC Stone") has paid a total penalty of **\$130,000** 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;
- perform an accurate daily reconciliation;
- give to ASIC a monthly reconciliation by the required time, on two separate occasions;
- notify ASIC that a daily reconciliation had not been performed in accordance with the respective market integrity rule, by the required time; and
- provide to ASIC an accurate ad hoc NTA return, on two separate occasions.

Background and circumstances

FC Stone is alleged to have contravened subsection 798H(1) of the *Corporations Act 2001* ("Corporations Act") by reason of contravening Rules 2.2.1(1)(b), 2.3.2, 2.3.3(2), 2.3.4(a) and 6.2.1(6) of the ASIC Market Integrity Rules (ASX 24 Market) 2010 ("MIR 2.2.1(1)(b)", "MIR 2.3.2", "MIR 2.3.3(2)", "MIR 2.3.4(a)" and "MIR 6.2.1(6)").

MIR 2.2.1(1)(b) provides:

'A Market Participant must demonstrate prudent risk management procedures, including, but not limited to...set and document maximum price change limits...'

MIR 2.3.2 provides:

'...a Market Participant must perform an accurate reconciliation, by 7.00 pm on the Business Day after the Business Day to which the reconciliation relates, of the aggregate balance held by it at the close of business on each Business Day in clients' segregated accounts...and the corresponding balance as recorded in the Market Participant's accounting records...The reconciliation...must set out...'

MIR 2.3.3(2) provides:

'The [monthly] reconciliation...must be given to ASIC by the last Business Day of the calendar month following the calendar month to which the reconciliation relates.'

MIR 2.3.4(a) provides:

'A Market Participant must notify ASIC, in writing, within 2 Business Days if...a reconciliation has not been performed in accordance with Rule 2.3.2 ...'

MIR 6.2.1(6), at the relevant times, provided:

'A Trading Participant must, if requested by ASIC in writing, give ASIC an ad hoc NTA return for the period specified in ASIC's request, containing the [set] information...and a [set] directors' declaration relating to the ad hoc NTA return...within 24 hours of receipt of ASIC's request.'

The term "NTA" defined in Rule 5.5.1 of the ASIC Market Integrity Rules (ASX 24 Market) 2010 has the same meaning when used in the infringement notice, namely:

"NTA" means the sum of the values of the assets (both fixed and current) owned by the Trading Participant or prospective Trading Participant as the case may be (such value being the lower of cost or market) less the sum of any liabilities (secured and unsecured) attaching to those assets or to the Trading Participant or prospective Trading Participant generally (and in the case of a partnership then attaching to the partners).

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

- 1) The ASIC Market & Participant Supervision team ("ASIC M&PS") conducted an onsite review of FC Stone's business in April 2012. As part of this review, ASIC M&PS issued notices seeking operational documentation.
- 2) From this review and earlier work in February 2012, ASIC M&PS identified a number of potential shortcomings with FC Stone's practices and procedures.

Contravention 1 (MIR 2.2.1(1)(b) – Limits)

- 3) On FC Stone's admission as a Market Participant of the Market in October 2011, FC Stone personnel held a meeting to determine appropriate Client limits, including maximum price change ("MPC") limits. FC Stone determined to set the MPC limits for each of its Clients at the default level of 999.9 basis points.
- 4) On 5 March 2012, FC Stone had in place a number of procedures which referred to setting limits, but these procedures did not specifically refer to the process for setting MPC limits, nor did they provide sufficient detail on how MPC limits were to be set.
- 5) FC Stone amended its procedures relating to setting Client limits in April 2013 ("Amended Procedures"). The Amended Procedures made explicit reference to MIR 2.2.1(1)(b) and stated "limits should be set based on an analysis of the Clients' financial capabilities, proposed trading activity and trading contracts".
- 6) The procedures in place on 5 March 2012 and the Amended Procedures, which were in place as at 27 August 2013, were not prudent risk management procedures for the purpose of MIR 2.2.1(1)(b) because they did not result in FC Stone setting and documenting appropriate MPC limits.
- 7) In addition, FC Stone's decision to set the MPC limits for each of its Clients at the default level of 999.9 basis points indicates that FC Stone did not demonstrate prudent risk management procedures during this period.

Contravention 2 (MIR 2.3.2 – Daily reconciliation of client funds); and Contravention 5 (MIR 2.3.4(a) – Obligation to notify ASIC about daily reconciliation)

- 8) On 23 March 2012, ASIC M&PS requested under notice a copy of the daily reconciliation prepared by FC Stone pursuant to MIR 2.3.2 for the Business Day 7 March 2012 ("7 March 2012 Daily Reconciliation").

- 9) The 7 March 2012 Daily Reconciliation provided by FC Stone to ASIC on 11 April 2012 contained inaccurate figures for three items and did not contain the information required by MIR 2.3.2(2)(d), MIR 2.3.2(2)(e) and MIR 2.3.2(2)(f).
- 10) As a result, the 7 March 2012 Daily Reconciliation was not performed in accordance with MIR 2.3.2.
- 11) Any notification to ASIC under MIR 2.3.4(a) that the 7 March 2012 Daily Reconciliation had not been performed in accordance with MIR 2.3.2 should have been made by 12 March 2012.
- 12) FC Stone did not notify ASIC of its failure to perform the 7 March 2012 Daily Reconciliation in accordance with MIR 2.3.2 by 12 March 2012.

Contravention 3 and 4 (MIR 2.3.3(2) – Monthly reconciliation of client funds)

- 13) On 8 October 2012, FC Stone gave to ASIC its reconciliation of the aggregate balance held by it at the close of business on the last Business Day of the calendar month July 2012 in clients' segregated accounts maintained under MIR 2.2.6 and the corresponding balance as recorded in its accounting records ("July 2012 Monthly Reconciliation").
- 14) The July 2012 Monthly Reconciliation should have been given to ASIC by 31 August 2012 in accordance with MIR 2.3.3(2).
- 15) On 8 October 2012, FC Stone gave to ASIC its reconciliation of the aggregate balance held by it at the close of business on the last Business Day of the calendar month August 2012 in clients' segregated accounts maintained under MIR 2.2.6 and the corresponding balance as recorded in its accounting records ("August 2012 Monthly Reconciliation").
- 16) The August 2012 Monthly Reconciliation should have been given to ASIC by 28 September 2012 in accordance with MIR 2.3.3(2).

Contravention 6 and 7 (MIR 6.2.1(6) – Reporting to ASIC (Ad hoc NTA requirements))

- 17) On 15 February 2012, ASIC M&PS requested that FC Stone provide an ad hoc NTA return under MIR 6.2.1(6) until further notice.
- 18) Pursuant to this request, on 17 February 2012, FC Stone provided an ad hoc NTA return for 16 February 2012 ("16 February 2012 NTA Return").
- 19) The 16 February 2012 NTA Return used data relating to 15 February 2012, and so was not an NTA return for the period requested by ASIC. As such, it did not satisfy the requirements of MIR 6.2.1(6).
- 20) Also pursuant to ASIC's request, on 21 February 2012, FC Stone provided an ad hoc NTA return for 17 February 2012 ("17 February 2012 NTA Return").
- 21) The 17 February NTA Return did not have any provision for accrued annual leave. The 17 February NTA Return was therefore not an accurate return and did not satisfy the requirements of MIR 6.2.1(6).

By reason of FC Stone's failure to:

- demonstrate prudent risk management procedures pertaining to setting and documenting MPC limits between 5 March 2012 and 27 August 2013, the MDP had reasonable grounds to believe that FC Stone contravened MIR 2.2.1(1)(b) and thereby contravened subsection 798H(1) of the Act (Contravention 1);

- perform an accurate daily reconciliation which included all required information for 7 March 2012, the MDP had reasonable grounds to believe that FC Stone contravened MIR 2.3.2 and thereby contravened subsection 798H(1) of the Act (Contravention 2);
- give to ASIC the July 2012 Monthly Reconciliation by 31 August 2012, the MDP had reasonable grounds to believe that FC Stone contravened MIR 2.3.3(2) and thereby contravened subsection 798H(1) of the Act (Contravention 3);
- give to ASIC the August 2012 Monthly Reconciliation by 28 September 2012, the MDP had reasonable grounds to believe that FC Stone contravened MIR 2.3.3(2) and thereby contravened subsection 798H(1) of the Act (Contravention 4);
- notify ASIC that the 7 March 2012 Daily Reconciliation had not been performed in accordance with MIR 2.3.2 by 12 March 2012, the MDP had reasonable grounds to believe that FC Stone contravened MIR 2.3.4(a) and thereby contravened subsection 798H(1) of the Act (Contravention 5);
- provide the requested ad hoc NTA return relating to 16 February 2012, the MDP had reasonable grounds to believe that FC Stone contravened MIR 6.2.1(6) and thereby contravened subsection 798H(1) of the Act (Contravention 6);
- provide the requested ad hoc NTA return relating to 17 February 2012, the MDP had reasonable grounds to believe that FC Stone contravened MIR 6.2.1(6) and thereby contravened subsection 798H(1) of the Act (Contravention 7).

Maximum pecuniary penalty that a Court could order

The maximum pecuniary penalty that a Court could order FC Stone to pay for contravening subsection 798H(1) of the Corporations Act:

- by reason of contravening MIR 2.2.1(1)(b), is \$1,000,000;
- by reason of contravening MIR 2.3.2, is \$1,000,000;
- by reason of contravening MIR 2.3.3(2), is \$1,000,000;
- by reason of contravening MIR 2.3.4(a), is \$100,000;
- by reason of contravening MIR 6.2.1(6), is \$1,000,000.

Pursuant to subsection 798K(2) of the Corporations Act, the maximum pecuniary penalty that may be imposed by the MDP and payable by FC Stone under an infringement notice given for contravening subsection 798H(1) of the Corporations Act:

- by reason of allegedly contravening MIR 2.2.1(1)(b), is \$600,000;
- by reason of allegedly contravening MIR 2.3.2, is \$600,000;
- by reason of allegedly contravening MIR 2.3.3(2), is \$600,000;
- by reason of allegedly contravening MIR 2.3.4(a), is \$60,000;
- by reason of allegedly contravening MIR 6.2.1(6), is \$600,000.

Penalty under the Infringement Notice

The total penalty under the infringement notice for the seven alleged contraventions of subsection 798H(1) of the Corporations Act that FC Stone must pay to the Commonwealth, is **\$130,000**, comprised respectively as follows:

- Contravention 1 – MIR 2.2.1(1)(b) – \$50,000;

- Contravention 2 – MIR 2.3.2 – \$10,000;
- Contravention 3 – MIR 2.3.3(2) – \$10,000;
- Contravention 4 – MIR 2.3.3(2) – \$20,000;
- Contravention 5 – MIR 2.3.4(a) – \$10,000;
- Contravention 6 – MIR 6.2.1(6) – \$10,000;
- Contravention 7 – MIR 6.2.1(6) – \$20,000.

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:

General

- (i) That the penalties, remedies and/or sanctions applied should promote market integrity along with confident and informed participation of investors in financial markets;
- (ii) The misconduct was serious and had the potential to damage public confidence in financial markets;
- (iii) That the penalties, remedies and/or sanctions applied should act as a deterrent to any future misconduct by the subject person. They should also act as a general deterrent to others from engaging in the same or similar conduct;
- (iv) The identification of six alleged contraventions over an approximately six month period during 2012 relating to FC Stone's accounting procedures indicates that FC Stone's accounting department, and the compliance controls around the accounting department, were not adequate to ensure full compliance with the market integrity rules. This suggests a systemic compliance failure by indicating a general lack of understanding of, and respect of compliance with, the market integrity rules regarding accounting requirements;
- (v) The MDP emphasises the importance of effective internal accounting procedures which are crucial to both the business of participants and to maintaining the integrity of the market;
- (vi) FC Stone did not detect any of the alleged contraventions. This fact suggests that FC Stone's procedures for detecting and escalating contraventions of the market integrity rules were not adequate;
- (vii) None of the misconduct giving rise to the alleged contraventions involved dishonesty. FC Stone did not attempt to conceal any of the misconduct;
- (viii) None of the misconduct resulted in any actual benefit accruing to FC Stone or any actual detriment to FC Stone's Clients or other Market Participants. There was no loss to investors;
- (ix) FC Stone had no prior disciplinary action taken against it nor any penalty imposed upon it under the market integrity rules or the operating rules of a financial market;
- (x) FC Stone co-operated with ASIC in the investigation of this matter, and engaged constructively with the ASIC Enforcement team in reaching a resolution of this matter, which saved time and costs;
- (xi) FC Stone expressed contrition and made an early decision not to dispute the alleged contraventions, thereby minimising the time and costs that would otherwise have been incurred;

- (xii) FC Stone undertook significant steps to remediate its procedures to ensure that any contravention in respect of the matters in this Notice does not recur. FC Stone worked to improve its compliance with the market integrity rules.

Contravention 1 (MIR 2.2.1(1)(b) – Limits)

- (i) 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;
- (ii) Market Participants are required to set and document appropriate pre-determined limits on each of their Client Accounts. They are specifically required to set and document appropriate MPC limits on each Client Account. Setting MPC limits at a maximum or default setting of 999.9 basis points is inadequate and does not demonstrate prudent risk management procedures as a Market Participant;
- (iii) The misconduct was careless on the part of FC Stone. Although FC Stone did consider at what levels the MPC limits on each of its Client Accounts should be set, it determined to set the MPC limits at the default level of 999.9 basis points. While some relevant factors were considered in making this decision, it was not appropriate to take into consideration or rely on the existence of the ASX 24 Market's Extreme Cancellation Range ("ECR"), as Market Participants have a primary responsibility to ensure that they exercise prudent risk management and the ECR is designed to function as a back-up only;
- (iv) FC Stone failed to demonstrate prudent risk management procedures and had its MPC limits set at 999.9 basis points for eighteen months, which is an unacceptably long period of time. However, there was no evidence of any adverse market impact or any loss to investors as a result of this misconduct. There was also no actual detrimental impact on FC Stone's Clients;
- (v) While FC Stone had in place internal procedures which resulted in it making a decision about the appropriate level at which to set the MPC limits on its Client Accounts, these procedures were not effective to ensure that an appropriate decision was made;
- (vi) FC Stone implemented new risk management procedures, and amended the MPC limits on its Client Accounts, to prevent recurrence of this misconduct.

Contravention 2 (MIR 2.3.2 – Daily reconciliation of client funds)

- (i) MIR 2.3.2 is explicit in that it involves a mandatory obligation to perform daily reconciliations, which are an essential part of a Market Participant's proper compliance process for protecting Client money. In an insolvency situation, Client money can be at risk if it is not properly segregated or accounted for;
- (ii) The failure by FC Stone to prepare an accurate daily reconciliation as required containing all required information for 7 March 2012 was careless on the part of FC Stone who neglected to ensure that it had the necessary understanding of the relevant accounting standards and principles, and suggests a systemic compliance failure;
- (iii) The misconduct relating to MIR 2.3.2 had no impact on public confidence in the market, or on the market itself. FC Stone's Client money was appropriately segregated at the relevant time, so there was minimal risk to Client money in the event of insolvency;
- (iv) FC Stone undertook significant remediation work to prevent recurrence of the misconduct, including refresher training for accounting staff regarding regulatory requirements, a regular training programme for accounting staff relating to regulatory updates on Client fund management and reporting, and new controls to ensure double-checking of daily reconciliations.

Contravention 3 and 4 (MIR 2.3.3(2) – Monthly reconciliation of client funds)

- (i) MIR 2.3.3(2) ensures that ASIC has available to it the information it requires to ensure that it can perform its supervisory role with respect to the efficiency and integrity of financial markets and the protection of investor funds;
- (ii) The failure to submit the July 2012 Monthly Reconciliation and the August 2012 Monthly Reconciliation by the required times resulted from an imprudent decision to have only one authorised signatory. In this sense, FC Stone was careless in that it neglected to comply with its obligations under MIR 2.3.3(2) due to lack of procedural foresight;
- (iii) FC Stone authorised an additional signatory to avoid recurrence of the misconduct.

Contravention 5 (MIR 2.3.4(a) – Obligation to notify ASIC about daily reconciliation)

- (i) MIR 2.3.4(a) also ensures that ASIC has available to it the information it requires to ensure that it can perform its supervisory role with respect to the efficiency and integrity of financial markets and the protection of investor funds;
- (ii) The failure to notify ASIC of the failure to perform the 7 March 2012 Daily Reconciliation in accordance with MIR 2.3.2 was careless;
- (iii) As noted above under the remedial actions for Contravention 2, FC Stone undertook remedial work in relation to its performance of MIR 2.3.2.

Contravention 6 and 7 (MIR 6.2.1(6) – Reporting to ASIC (Ad hoc NTA requirements))

- (i) MIR 6.2.1(6) is an important tool which enables ASIC quickly to assess the solvency of Trading Participants between regular reporting periods. Compliance with this rule assists ASIC to perform its supervisory role and protect investor funds and the overall integrity of the market;
- (ii) MIR 6.2.1(6) should be read as including a requirement that any ad hoc NTA return given to ASIC pursuant to a request under MIR 6.2.1(6) be accurate. This interpretation is necessary to give effect to the purpose of the rule;
- (iii) The failure to provide the 16 February 2012 NTA Return with the correct data was careless, and arose because FC Stone neglected to ensure that the 16 February 2012 NTA Return was based on source data for the correct date;
- (iv) The provision of the inaccurate 17 February 2012 NTA Return was careless, because it arose from an accounting practice which did not accord with the relevant accounting standard;
- (v) The misconduct relating to MIR 6.2.1(6) had no impact on public confidence in the market, or on the market itself. However, the failure to provide requested NTA returns did impact ASIC's ability to perform immediate oversight of FC Stone's business;
- (vi) In addition to the remedial work outlined above, FC Stone introduced new controls to ensure that the accuracy of all NTA returns is reviewed before submission.

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 subparagraphs 7.2A.15(4)(b)(i) and (ii) of the Regulations, FC Stone has complied with the infringement notice, such compliance is not an admission of guilt or liability, and FC Stone is not taken to have contravened subsection 798H(1) of the Corporations Act.

Further information on market integrity infringement notices, the market integrity rules and 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 "Regulatory Resources > Markets > Market Integrity Rules" and "Regulatory Resources > Markets > Markets Disciplinary Panel".