Markets Disciplinary Panel

23 September 2015 **MDP CIRCULAR 2015–03**

DISCIPLINARY MATTER – D J Carmichael Pty Limited

D J Carmichael Pty Limited ("DJ Carmichael") has paid a penalty of **$300,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel ("MDP"). The penalty was for DJ Carmichael entering bids and dealing in a product for a client where DJ Carmichael intended to create a false or misleading appearance with respect to the price of that product.

Background and circumstances

DJ Carmichael is alleged to have contravened subsection 798H(1) of the *Corporations Act 2001* ("Corporations Act") by reason of contravening Rule 5.7.1(b)(i) of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.7.1(b)(i)"), which provides that:

> "***A Market Participant must not make a Bid or Offer for, or deal in, any Products on account of any other person where the Market Participant intends to create a false or misleading appearance of active trading in any Product or with respect to the market for, or the price of, any Product***."

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

1) On 14 December 2010, DJ Carmichael commenced buying the fully paid ordinary units of LinQ Resources Fund ("LinQ Fund") having ASX code 'LRF', on behalf of LinQ Capital Limited ("LinQ Capital"), the Responsible Entity for LinQ Fund, pursuant to an On-Market buyback of LRF announced on 26 November 2010 ("LRF Buyback"). The DJ Carmichael Employee responsible for executing the LRF Buyback was a Designated Trading Representative or DTR for DJ Carmichael ("DJ Carmichael DTR").
2) From 14 December 2010 to 15 July 2011, the DJ Carmichael DTR entered Bids for LRF ("LRF Bids") and dealt in LRF pursuant to the LRF Buyback. Whilst LinQ Capital provided general instructions to the DJ Carmichael DTR regarding the LRF Buyback, the DJ Carmichael DTR had discretion regarding the price, volume and timing of the LRF Bids (although LinQ Capital's account was not a Managed Discretionary Account).
3) Although the DJ Carmichael DTR may initially have made LRF Bids and dealt in LRF for the genuine purpose of conducting the LRF Buyback, from 16 May 2011 to 15 July 2011 ("Relevant Period"), and possibly earlier, the DJ Carmichael DTR believed that LinQ Capital wanted him to execute Market Transactions in LRF with the aim of supporting the price of LRF. Consequently, during the Relevant Period, the DJ Carmichael DTR made Bids for, and dealt in LRF, with the intention of supporting the price of LRF thereby creating a false and misleading appearance with respect to the market for, or the price of, LRF, in breach of MIR 5.7.1(b)(i).

4) On 15 July 2011, the DJ Carmichael DTR sent an internal email ("July Email") to a junior DJ Carmichael Employee ("Junior Employee"), relevantly:

- instructing that the LRF price was to be supported; and
- outlining a strategy to support the LRF price.

5) DJ Carmichael's trading in LRF during the Relevant Period displayed characteristics consistent with an intention to support the price of LRF such that the closing price of LRF would not fall below a pre-determined price level, as evidenced by the relevant trading data, in that:

- DJ Carmichael limited the entry of LRF Bids and purchases of LRF to situations where:
  - the price of LRF had decreased below the pre-determined price level; or
  - the price of LRF, absent the entry of the LRF Bids, would likely have decreased below the pre-determined price level;
- the entry and execution of LRF Bids created significant price impact by creating a large percentage of total price increases, particularly price increases just before the close of trading and setting the closing price of LRF on 35 of the 44 Trading Days during the Relevant Period;
- DJ Carmichael consistently relinquished opportunities to buy LRF at the lowest possible price and consistently purchased LRF at the highest prices at which LRF had traded on the relevant Trading Days, including in situations where there were cheaper buying opportunities earlier on those days; and
- DJ Carmichael created price impact for minimal consideration by limiting the buying, and therefore the cost, of purchasing LRF, including, among other things, by tailoring the LRF Bids to consume only a small proportion of the LRF on Offer at or below the LRF Bid price.

6) The relevant trading data also evidenced that:

- between 15 and 31 May 2011, DJ Carmichael traded with the intention of ensuring that the closing price of LRF did not fall below $0.94;
- in early June 2011, DJ Carmichael continued to trade with the intention of ensuring that the closing price of LRF did not fall below $0.94. However, as the Offer side and market for LRF became volatile and the price of LRF deteriorated throughout June 2011, DJ Carmichael was no longer able to support the closing price of LRF at $0.94 without trading in large volumes. DJ Carmichael therefore amended its trading strategy during June 2011, progressively stepping up the price of LRF, or entering Bids low in priority which were unlikely to trade, with the apparent intention of creating an appearance of demand for LRF and to protect against further price decreases in LRF while minimising the cost of trading in LRF; and
- between 1 and 15 July 2011, DJ Carmichael's trading in LRF was consistent with the strategy set out in the July Email, and with an intention of ensuring that the closing price of LRF did not fall below $0.84.

7) Pursuant to section 912E of the Corporations Act, ASIC sought DJ Carmichael's assistance in relation to DJ Carmichael's trading in LRF by letter dated 4 July 2011. This initially put DJ Carmichael on notice of ASIC's enquiries. On 19 July 2011, ASIC telephoned DJ Carmichael's Risk and Compliance team, and outlined ASIC's concerns regarding DJ

Carmichael's trading in LRF, including closing high on late or last trades, following which DJ Carmichael commenced an investigation into the matter. DJ Carmichael subsequently engaged a lawyer and, on 26 July 2011, lodged a self-report pursuant to section 912D of the Corporations Act. The self-report noted the July Email and advised that the email gave DJ Carmichael 'reason to believe inappropriate activity'.

By reason of DJ Carmichael during the Relevant Period having entered LRF Bids and dealt in LRF on account of LinQ Capital, where DJ Carmichael intended to create a false or misleading appearance with respect to the price of LRF (namely by making Bids for and trading in LRF with the aim of supporting the price of LRF), the MDP had reasonable grounds to believe that DJ Carmichael contravened MIR 5.7.1(b)(i), and thereby contravened subsection 798H(1) of the Corporations Act.

Maximum pecuniary penalty that a Court could order

The maximum pecuniary penalty that a Court could order DJ Carmichael to pay for contravening subsection 798H(1) of the Corporations Act by reason of contravening MIR 5.7.1(b)(i), 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 DJ Carmichael under an infringement notice given for allegedly contravening subsection 798H(1) of the Corporations Act by reason of allegedly contravening MIR 5.7.1(b)(i), is $600,000.

Penalty under the Infringement Notice

The penalty under the infringement notice for the alleged contravention of subsection 798H(1) of the Corporations Act that DJ Carmichael must pay to the Commonwealth, is **$300,000.**

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:

(i) That the remedies applied should:

- promote market integrity and the confident and informed participation of investors in financial markets; and
- act as a deterrent to any future misconduct by the subject person; and
- also act as a general deterrent to others from engaging in the same or similar conduct;

(ii) In the MDP's view, MIR 5.7.1(b)(i) is aimed at upholding market integrity i.e. that markets remain fair and efficient. Protecting against market misconduct and promoting the disclosure of important market-related information, is designed to ensure that investors can be confident in making sound investment decisions. The overall objective is an active market that facilitates the capital formation important to national economic growth and prosperity;

(iii) In the context of domestically licensed financial markets the concept of market integrity is to be read in light of the objective in paragraph 760A(c) of the Corporations Act – 'to promote fair, orderly and transparent markets for financial products'. Fair, orderly and transparent means a level playing field (free from misconduct and synonymous with investor protection) characterised by sound ethical values and judgement where regular bids, offers and sales (past and real-time) can be seen and reflect genuine supply and demand (i.e. prices represent all publicly available information);

(iv) Making Bids and dealing in a Product absent the intent to take a genuine or bona fide position in the market for that Product, is significant for the reason that the resultant trading data creates a false and misleading appearance of supply, demand and/or liquidity and ultimately price or market valuation. Among other things, trading data is used by investors in making informed decisions by being able to assess supply, demand and/or liquidity and ultimately price or market valuation. False and misleading trading data thereby distorts a market and has the potential to undermine investor or public confidence that financial markets are level playing fields and that prices reflect all available information. A less active market inhibits capital formation which may result in lower national economic growth and prosperity. Accordingly, for these reasons, a breach of MIR 5.7.1(b)(i) is of a very serious nature;

(v) The misconduct giving rise to the contravention the subject of this matter was characterised as conduct of a dishonest and deliberate type;

(vi) Manipulative trading for any period of time is significant. For that period of time to be approximately two months is unacceptable given the increased potential negative impact on market integrity;

(vii) There was only one breach of MIR 5.7.1(b)(i) alleged;

(viii) The misconduct was localised to the DJ Carmichael DTR's part. The MDP noted the involvement of the Junior Employee, however the Junior Employee's involvement was as a subordinate under instruction from a senior Employee or the DJ Carmichael DTR. Accordingly, the misconduct was not systemic in the sense that it was widespread and related to other parts of DJ Carmichael beyond the DJ Carmichael DTR's part;

(ix) The benefit derived was commission to the value of $5,933.55. However the potential to derive benefit via goodwill was more significant. This was not viewed favourably by the MDP because it appeared that personal and commercial interests had been favoured over regulatory obligations. Additionally, the detriment to third parties was real and apparent;

(x) The misconduct impacted the financial market because the manipulative trading interfered with the fairness and efficiency of the market given it did not reflect genuine supply and demand. This had the potential to substantially damage public confidence;

(xi) Of particular concern to the MDP, was the DJ Carmichael DTR's targeting of the LRF closing price i.e. to manipulate the price of LRF at the close of trading so that it was higher than might otherwise be the case. This was significant for the obvious reason that the closing price provides a daily reference price which represents the latest market valuation until the next Trading Day. Among other things, closing prices are used by investors in making informed decisions by being able to assess change in market valuation over time;

(xii) That the DJ Carmichael DTR intended to support the price of LRF during the Relevant Period in particular with multiple Bids just before or on Market close and Bids executed for minimal value just before or on Market close such that the closing price of LRF would not fall below a pre-determined price, was not consistent with the dealings of a genuine buyer undertaking an On-Market buyback;

(xiii) Although DJ Carmichael had in place procedures for detecting breaches of the market integrity rules, these procedures failed to detect the breach the subject of this matter;

(xiv) The DJ Carmichael DTR's disregard for the market integrity rules and the intentional instruction of junior staff to disregard the same and engage in the perpetuation of the misconduct, was not viewed favourably by the MDP;

(xv) Of particular concern to the MDP was the Junior Employee's apparent reluctance to bring to attention the misconduct. In the MDP's view, inaction, silence or the fear of speaking out, is indicative of a culture not conducive to compliance with the market integrity rules. That the Junior Employee remained silent after receipt of the July Email, and attempted to perpetuate the misconduct, appeared to be indicative of a corporate culture not conducive to compliance with the market integrity rules;

(xvi) Also of particular concern to the MDP was DJ Carmichael's lack of effective action after being alerted by ASIC letter on 4 July 2011 to DJ Carmichael's trading in LRF. Given DJ Carmichael's trading in LRF and the LRF Buyback on foot, it was reasonable in the circumstances to at the very least immediately escalate the said letter to senior management. However this was not done, nor was anything else done to the extent that it caused the misconduct to be detected and addressed. Accordingly, it appeared that as a result of the inaction, the manipulative trading in LRF continued unabated post 4 July 2011;

(xvii) While the MDP had regard to DJ Carmichael self-reporting the breach to ASIC, it also noted that it was ASIC who alerted DJ Carmichael to the misconduct, and made DJ Carmichael aware of the misconduct;

(xviii) DJ Carmichael took steps to prevent recurrence of the breach, including:

- instigating an immediate investigation (including retaining external legal assistance) upon becoming aware of ASIC's concerns on 19 July 2011;
- undertaking a detailed and considered review of its operations during which DJ Carmichael considered many commercial and compliance issues;
- enhancing its procedures for ensuring compliance with the market integrity rules including by introducing random audits of trading by the DJ Carmichael Compliance Team; and
- ceasing to be a Market Participant of the ASX on 19 April, instead submitting Orders through a third party service provider;

(xix) DJ Carmichael took the alleged contravention very seriously and demonstrated contrition;

(xx) DJ Carmichael had no prior contraventions found against it by the MDP, but had been sanctioned by the ASX Disciplinary Tribunal on three published occasions since 2007 relating respectively to discretionary trading, engaging in unprofessional conduct and inappropriate conduct during a buyback;

(xxi) DJ Carmichael co-operated with ASIC throughout ASIC's investigation and did not dispute any material facts; and

(xxii) DJ Carmichael agreed not to contest the alleged contravention, 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 subparagraphs 7.2A.15(4)(b)(i) and (ii) of the Regulations, DJ Carmichael has complied with the infringement notice, such compliance is not an admission of guilt or liability, and DJ Carmichael 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".