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Contents

Markets Disciplinary Panel: Infringement Notice

Recipient: UBS Securities Australia Limited

The recipient has complied with the infringement notice. Compliance is not an admission of guilt or liability; and the recipient is not taken to have contravened subsection 798H(1) of the *Corporations Act 2001*.

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PART 7.2A OF THE CORPORATIONS REGULATIONS 2001 INFRINGEMENT NOTICE

To: UBS Securities Australia Limited ACN 008 586 481
Level 16, 2 Chifley Square
Sydney NSW 2000

Matter: MDP 4064/17

Date given: 17 May 2017

TAKE NOTICE: The Australian Securities and Investments Commission (“ASIC”) gives this infringement notice to UBS Securities Australia Limited (“UBS”) under regulation 7.2A.04 of the Corporations Regulations 2001 (“the Regulations”).

To comply with this notice UBS must pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **\$140,000**.

Unless a contrary intention appears, capitalised terms used in this notice have the same meaning as those defined in Rule 1.4.3 of the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 (“the Competition Rules”) as in force at the time of the conduct.

Details of the alleged contraventions

1. UBS was a Participant in the respective Markets operated by ASX Limited and Chi-X Australia Pty Ltd at all relevant times and was required by subsection 798H(1) of the *Corporations Act 2001* (“the Act”) to comply with the Competition Rules.
2. Rule 4A.4.2(1) of the Competition Rules provided:
 - (1) ... [A] Participant that operates a Crossing System must ensure that the Crossing System deals fairly and in due turn with:
 - (a) Clients’ Orders; and
 - (b) a Client Order and an Order of the Participant trading as Principal.
3. Rule 4A.5.1(1) of the Competition Rules provided:
 - (1) ... [A] Participant that operates a Crossing System must: ...
 - (b) monitor use of its Crossing System for compliance with the operating procedures of the Crossing System ...
4. Rule 1.4.3 of the Competition Rules defines a “Crossing System” to mean:

any automated service provided by a Participant which matches or executes Client Orders with Orders of:

- (a) the Participant;
- (b) other clients of the Participant; or
- (c) any other person whose Orders access the automated service,

otherwise than on an Order Book.

5. UBS has comprehensive and sophisticated arrangements (including complex algorithms, a smart order router and other decision making tools) which access multiple liquidity venues. Clients of UBS that place Orders with UBS also have access to a number of automated strategies for execution of Orders which are tailored to achieve certain objectives and outcomes set by the client.
6. The Markets Disciplinary Panel (the “MDP”) was satisfied that, since August 2005, UBS operated a Crossing System known as Price Improvement Network (“UBS PIN”). Orders are executed within UBS PIN using algorithms that reflect the client’s strategy. UBS has the discretion to “slice and dice” the Orders and enter, amend or withdraw the Orders, as appropriate and as determined by its algorithms to achieve best execution. An Order is only routed to UBS PIN where there is price improvement. Any Orders that are routed to UBS PIN are filled based on available executable volume and, where there is insufficient executable volume, the Orders are partially filled.

Crossing Systems: dealing with orders “fairly and in due turn”

7. The MDP has reasonable grounds to believe that UBS contravened Competition Rule 4A.4.2(1) and thereby contravened subsection 798H(1) of the Act between 1 December 2014 and 28 June 2015 in respect of the following conduct:
 - (a) a deficiency in the hard coded logic within UBS PIN caused the unfilled portion of a number of partially executed Orders routed to UBS PIN to lose time priority in circumstances where another Order in relation to the same financial product with the same price parameters was resting in UBS PIN;
 - (b) a total of 83,703 Client Orders lost time priority as follows:
 - (i) 58,775 Client Orders lost time priority to other Client Orders (of which 4,004 would have executed earlier than they did had they not lost priority);
 - (ii) 24,928 Client Orders lost time priority to Orders of UBS trading as Principal (of which 1,553 would have executed earlier than they did had they not lost priority).
8. Competition Rule 4A.4.3 sets out a list of factors to consider in determining whether Competition Rule 4A.4.2 has been complied with. The timing and sequencing of Orders is a relevant factor. The MDP considers that where Orders routed to a Crossing System lose time priority while resting in the Crossing System, it could not be said that the Crossing System deals “fairly and in due turn” with the Orders. This was the case even though, at the time the Orders were initially entered into the Crossing System, they

were dealt with in accordance with price and time priority. The unfilled portion of a partially executed Order, which lost priority, remains an Order to which the requirement to deal “fairly and in due turn” applies.

9. There was one contravention of Competition Rule 4A.4.2(1) arising from a single course of conduct. The deficiency in the hard coded logic within UBS PIN which caused partially filled Orders to lose priority in certain circumstances operated in exactly the same way for Client Orders or Orders of UBS trading as Principal.
10. The MDP found that 10 Retail Clients and 536 Wholesale Clients were affected by the loss in priority. However, none of the Retail Clients suffered any financial loss as a result of the loss in priority, and the loss to Wholesale Clients was negligible.

Crossing Systems: Monitoring compliance

11. The MDP had reasonable grounds to believe that UBS contravened Competition Rule 4A.5.1(1) and thereby contravened subsection 798H(1) of the Act between 10 November 2013 and 28 June 2015 in respect of the following conduct:
 - (a) UBS maintained an “Operating Procedures Manual”, which outlined various processes, controls and monitoring that UBS had in place for its Crossing Systems including UBS PIN, and in particular provided that “[a]ll orders, irrespective of the user, are accepted by the Crossing Systems and queued on the basis of time and price priority”. UBS’ “Crossings Systems Monitoring Framework” also provided that quality assurance testing is conducted every 6 months with respect to the price and time priority control in UBS PIN;
 - (b) despite these processes and controls, UBS failed to identify issues with UBS PIN whereby certain partially filled Orders lost priority until those issues were detected and reported to ASIC in June 2015 and a permanent fix to correct the deficiency was implemented by UBS on 29 June 2015.
12. The MDP construes Competition Rule 4A.5.1(1)(b) as implying a reasonable standard of monitoring compliance with the operating procedures of the Crossing System. The MDP found that, over a number of half-yearly cycles of quality assurance testing in relation to price and time priority, UBS did not test for the consequences of partially filled Orders and therefore fell short of a reasonable standard of monitoring compliance with the operating procedures of UBS PIN.
13. In considering this matter and the appropriate penalty, the MDP commented:
 - (a) as the trading that occurs on a Crossing System, essentially a “dark pool”, is less transparent than the trading that occurs on a “lit” Market, it is incumbent on Participants that operate Crossing Systems to be diligent in ensuring those Crossing Systems function fairly at all times;
 - (b) a Crossing System which is complex will generally require a higher degree of monitoring to ensure compliance with its operating procedures. Irrespective of the complexity of the Crossing System, the monitoring of its operation must be sufficient to detect and rectify any deficiencies in fundamental aspects. The

treatment of Orders according to price and time priority is a fundamental aspect;

- (c) UBS was careless in failing to detect that UBS PIN was not functioning correctly in relation to partially filled Orders, given that the lack of detection persisted for over 18 months during which UBS performed at least 3 half-yearly quality assurance cycles to test for price and time priority.
14. The MDP took into account the following mitigating factors. The 83,703 Orders that were affected by the loss in time priority represented around 1% of all Orders entered into UBS PIN during the relevant period. No person affected by the loss in priority suffered any material loss. The impact on the market, including confidence in participating in “dark pools”, was considered to be minimal. UBS did not derive any material benefit as a result of the conduct. UBS self-reported the conduct once it became aware of it, and cooperated with ASIC throughout its investigation. UBS have also implemented a number of recommendations made by ASIC with respect to its policies and procedures around analysis of monitoring reports.
15. UBS has been previously sanctioned by the MDP in June and September 2013 for alleged contraventions of the market integrity rules, but those matters involved conduct of a different kind to this matter.
16. The penalties payable under this infringement notice for the alleged contraventions of subsection 798H(1) of the Act are as follows:
- (a) by reason of contravening Competition Rule 4A.4.2—\$100,000;
 - (b) by reason of contravening Competition Rule 4A.5.1—\$40,000.

Other information

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

- by reason of contravening Competition Rule 4A.4.2—\$1,000,000;
- by reason of contravening Competition Rule 4A.5.1—\$100,000.

The maximum pecuniary penalty payable under an infringement notice in relation to an alleged contravention of subsection 798H(1) of the Act is:

- by reason of contravening Competition Rule 4A.4.2—\$600,000;
- by reason of contravening Competition Rule 4A.5.1—\$60,000.

To comply with this infringement notice, UBS must pay the penalty within the compliance period. The compliance period starts on the day on which this notice is given to UBS and ends 27 days after the day on which it is given. Payment is made by bank cheque to the order of “Australian Securities and Investments Commission”.

The effects of compliance with this infringement notice are:

- (a) any liability of UBS to the Commonwealth for the alleged contravention of subsection 798H(1) of the Act is discharged; and

- (b) no civil or criminal proceedings may be brought or continued by the Commonwealth against UBS for the conduct specified in the infringement notice as being the conduct that made up the alleged contraventions of subsection 798H(1) of the Act; and
- (c) no administrative action may be taken by ASIC under section 914A, 915B, 915C or 920A of the Act against UBS for the conduct specified in the infringement notice as being the conduct that made up the alleged contraventions of subsection 798H(1) of the Act; and
- (d) UBS is not taken to have admitted guilt or liability in relation to the alleged contraventions; and
- (e) UBS is not taken to have contravened subsection 798H(1) of the Act.

UBS may choose not to comply with this infringement notice, but if UBS does not comply, civil proceedings may be brought against it in relation to the alleged contraventions.

UBS may apply to ASIC for withdrawal of this infringement notice under regulation 7.2A.11 of the Regulations; and for an extension of time to comply under regulation 7.2A.09 of the Regulations.

ASIC may publish details of this notice under regulation 7.2A.15 of the Regulations.



Grant Moodie

Special Counsel to the MDP

with the authority of a Division of ASIC

Note: Members of the Markets Disciplinary Panel constitute a Division of ASIC as delegates of the members of the Division for the purposes of considering the allegations covered by this notice.