



**ASIC**

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Investments Commission

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## Contents

**Markets Disciplinary Panel:** Infringement Notice

**Recipient:** Merrill Lynch (Australia) Futures 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:** Merrill Lynch (Australia) Futures Limited ACN 003 639 674  
Level 34, 1 Farrer Place  
SYDNEY NSW 2000

Matter: MDP 6028/17  
Date given: 14 August 2017

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

To comply with this notice MLAF must pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **\$60,000**.

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 (ASX 24 Market) 2010 (“the Rules”) as in force at the time of the conduct.

### Details of the alleged contraventions

1. MLAF was a Market Participant in the ASX 24 Market between 22 October 2010 and 20 June 2016 (the “relevant period”) and was required by subsection 798H(1) of the *Corporations Act 2001* (“the Act”) to comply with the Rules.
2. Rule 2.2.1(1)(a) and (b) of the Rules respectively state:

A Market Participant must demonstrate prudent risk management procedures, including ...:

  - (a) set and document appropriate pre-determined Order and/or position limits on each of its Client Accounts, including a volume per Order limit, an aggregate loss limit and an aggregate net session limit, based on the Market Participant’s analysis of the Clients’ financial resources or other relevant factors;
  - (b) set and document maximum price change limits ...
3. Throughout the relevant period, MLAF provided access to the ASX 24 Market using 7 pathways. Generally, each pathway comprised an upstream order system and downstream terminals. MLAF, when entering Orders into the ASX 24 Market, acted on behalf of two Clients, both related entities of MLAF. Therefore, there were two Client Accounts. Each of these Clients had underlying clients for whom they were acting.
4. MLAF had a “Futures & Options Limits & Connections” procedures document in place. The document states that it “outlines the types of available limits and the limit setting procedure” and that the “[Futures and Options] Product Development Team works in

conjunction with the Risk & Margin Teams to apply limits to accounts based on an analysis of financial resources, anticipated trading strategies, open positions, intra-day exposures and other relevant factors”.

5. In 2016, following growth in its business, MLAF commenced an ad hoc review of market limits that applied at the downstream terminal level and, having identified a number of terminals that had limits set at ASX 24 Market default levels, broadened the scope of the review to examine the limits that applied to the upstream order systems.
6. MLAF identified 4 pathways that had inappropriate limits to varying degrees:
  - (a) Pathway 1, used by underlying clients based in North America and internal users, had volume limits and maximum price change limits set at ASX 24 Market default levels at both the downstream terminals level and the upstream order system level;
  - (b) Pathway 2, which had no active users of this pathway throughout the relevant period, had volume limits and maximum price change limits set at the ASX 24 Market default levels at both the downstream terminals level and the upstream order system level;
  - (c) Pathway 3, a customised pathway for a sophisticated client – a financial services licensee and ASX Market Participant – which had direct market access through MLAF, had volume limits and maximum price change limits set at the ASX 24 Market default levels at both the downstream terminals level and the upstream order system level;
  - (d) Pathway 4, which was the core pathway for underlying clients based in the Asia-Pacific region, had appropriate limits set at the upstream order system level but ASX 24 Market default limits set for some of the downstream terminal levels.
7. The ASX 24 Market default limits were not appropriate for MLAF or its Clients.
8. The Markets Disciplinary Panel (“the MDP”) has reasonable grounds to believe that MLAF during the relevant period:
  - (a) contravened Rule 2.2.1(1)(a) by reason of failing to set and document appropriate volume limits for each Client Account (“alleged contraventions 1 and 2”); and
  - (b) contravened Rule 2.2.1(1)(b) by reason of failing to set and document appropriate maximum price change limits (“alleged contravention 3”).
9. If the alleged contraventions of each rule were taken in isolation, the penalty would have been \$50,000 for each rule. Having regard to the totality of the conduct to ensure that the combined penalty is not excessive, the penalty payable for each alleged contravention is as follows:

Alleged Contravention	Rule	Penalty
1	2.2.1(1)(a)	\$40,000
2	2.2.1(1)(a)	Nil
3	2.2.1(1)(b)	\$20,000

10. The total penalty payable is \$60,000.
11. MLAF was careless in failing to identify the inappropriateness of volume limits and maximum price change limits over a period of almost six years. The lack of appropriate limits at both the downstream terminal level and upstream order system level for some of the pathways is a cause for concern. That said, the MDP appreciates the difficulty in identifying issues relating to limits in circumstances where post-trade alerts have not been triggered, particularly given the tendency of compliance departments to sensibly adopt risk-based approaches to reviewing their systems.
12. The MDP took into account the following general mitigating factors. MLAF identified the issues from their own review, self-reported the breach to ASIC, promptly took steps to remedy the breach once MLAF became aware of it, and cooperated with ASIC following the report. There was no apparent client or market impact. MLAF has a relatively insignificant disciplinary history, having been sanctioned by the ASX Disciplinary Tribunal in 2010 for allegedly contravening an unrelated rule.
13. In relation to the particular problematic pathways, the MDP also considered it mitigating that Pathway 4 had appropriate limits set at the upstream order system level. The fact that there were no active users of Pathway 2 throughout the relevant period was a mitigating factor. The MDP did not consider it mitigating that Pathway 3 was exclusively used by a sophisticated client with direct market access – the obligation to set and document appropriate limits is imposed on the Market Participant.
14. The penalty for the second alleged contravention of Rule 2.2.1(1)(a) was determined to be nil because of the closely related circumstances in which the alleged contraventions of Rule 2.2.1(1)(a) occurred, including that both Clients were related to MLAF.
15. The differences in penalties in relation to the alleged contraventions of Rule 2.2.1(1)(a) (volume limits) and Rule 2.2.1(1)(b) (maximum price change limits) reflect the relative risks to the market if the rule is not complied with. Although the rules relating to the setting and documentation of appropriate volume limits complement the operation of the maximum price change limits, the MDP considers the potential for large orders to magnify the potential damage to the market in instances where orders are incorrectly priced. Furthermore, orders with excessive volumes will not be cancelled by ASX, unlike Orders at prices that significantly deviate from the market price.
16. In the matter of FC Stone Australia Pty Ltd (MDP 9601/14), the MDP issued an infringement notice specifying a penalty of \$50,000 for an alleged contravention of Rule 2.2.1(1)(b). The MDP noted the following differences between FC Stone and the current matter. FC Stone did not have appropriate maximum price change limits in place over a period of 18 months, whereas MLAF did not have appropriate limits over a longer period of almost 6 years. However, in the matter of FC Stone, it was ASIC's Market and Participants Surveillance team, rather than FC Stone itself, that had identified a number of potential shortcomings with FC Stone's practices and procedures. In contrast, MLAF itself identified the issues with their limits.

### **No adverse finding**

17. The MDP also made a finding that it did not have reasonable grounds to believe that MLAF contravened Rules 2.2.1(1)(c) or 2.2.8 of the Rules.

18. Rule 2.2.1(1)(c) of the Rules relevantly states:

A Market Participant must demonstrate prudent risk management procedures, including ...:

- (c) the limits determined in Rules 2.2.1(1)(a) ... and (b) must be input by a Market Participant's risk manager into Trading Platform account maintenance and will be established as preset accounts;

19. Rule 2.2.8(1) of the Rules relevantly states:

A Market Participant must have appropriate supervisory policies and procedures to ensure compliance by the Market Participant and each person involved in its business as a Market Participant with these Rules, the Market Operating Rules and the Corporations Act.

20. The MDP construes Rule 2.2.1(1)(c) as being concerned with ensuring the separation of roles performed by those who could create market risk (i.e. persons entering orders on the Trading Platform) from those who manage market risk (i.e. the risk manager/s of the Market Participant). The MDP was satisfied that such separation of roles were in place during the relevant period.

21. The MDP construes Rule 2.2.8(1) as being concerned with supervisory policies and procedures from an organisational governance and corporate culture perspective. MLAF had a "Futures & Options Limits & Connections" supervisory procedures document in place. The MDP was mindful of not setting unreasonable standards for Market Participants. While the supervisory procedures were not sufficiently comprehensive to identify at an earlier point in time the inappropriate settings of some market limits in relation to some pathways to the market, the MDP did not consider the conduct of MLAF to have fallen short of the norm of conduct expected of a reasonable Market Participant under Rule 2.2.8(1).

22. The MDP recognised the inevitability of particular oversights, particularly where a risk-based approach is taken to review systems and settings. A risk-based approach to compliance is a reasonable approach to take. The fact that MLAF, following the growth of its business, initiated a compliance review of market limits on both its downstream terminals and upstream order systems in 2016, which identified some inappropriate limits in relation to some pathways to the market, was indicative of a culture that was conducive to compliance with the Rules.

### Other information

The maximum pecuniary penalty that a Court could order MLAF to pay for contravening subsection 798H(1) of the Act by reason of contravening Rule 2.2.1(1) is \$1,000,000.

The maximum pecuniary penalty that may be payable by MLAF under an infringement notice in relation to the alleged contravention of Rule 2.2.1(1) is \$600,000.

To comply with this infringement notice, MLAF must pay the penalty within the compliance period. The compliance period starts on the day on which this notice is given to MLAF 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 MLAF 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 MLAF 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 MLAF 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) MLAF is not taken to have admitted guilt or liability in relation to the alleged contraventions; and
- (e) MLAF is not taken to have contravened subsection 798H(1) of the Act.

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

MLAF 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 Markets Disciplinary Panel

with the authority of a Division of the Australian Securities and Investments Commission

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.