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Contents

Markets Disciplinary Panel: Infringement Notice

Recipient: Merrill Lynch Equities (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: Merrill Lynch Equities (Australia) Limited
Level 34, Governor Phillip Tower
1 Farrer Place
SYDNEY NSW 2000

Matter: MDP 5863/17
Date given: 3 November 2017

TAKE NOTICE: The Australian Securities and Investments Commission (“ASIC”) gives this infringement notice to Merrill Lynch Equities (Australia) Limited (ACN 006 276 795) (“MLEA”) under regulation 7.2A.04 of the Corporations Regulations 2001 (“Regulations”).

To comply with this notice MLEA 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 following market integrity rules as in force at the time of the conduct:

- ASIC Market Integrity Rules (Competition in Exchange Markets) 2011; and
- ASIC Market Integrity Rules (Chi-X Australia Market) 2011.

These market integrity rules are respectively referred to as the Competition Rules and the Chi-X Rules.

Details of the alleged contraventions

1. MLEA was a Market Participant in the Market operated by Chi-X Australia Pty Ltd (“Chi-X Market”) between July 2014 and April 2016 (“Full Relevant Period”) and was required by subsection 798H(1) of the Act to comply with the Competition Rules and the Chi-X Rules.
2. Competition Rule 3.1.1(4) relevantly provided:
 - (4) If a Wholesale Client provides a Participant with instructions (*Wholesale Client's Instructions*) that are inconsistent with the Participant obtaining the best outcome under subrule (1) for the Wholesale Client and that are:
 - (a) clear and unambiguous;

- (b) In Writing, or if provided to the Participant verbally, recorded by the Participant and retained by the Participant for a period of seven years; and
- (c) not contained within the standard terms and conditions of a client agreement provided by the Participant to the client, but which may be standing instructions or specific Order by Order instructions,

the Participant must take reasonable steps to handle and execute the Order or Orders in a way which satisfies the Wholesale Client's instructions.

3. Competition Rule 3.1.1(5)(a) relevantly provided:

(5) If a standing instruction is given to a Participant under paragraph (4)(c), that instruction must be:

- (a) periodically reviewed to ensure it remains possible for the Participant to satisfactorily perform the instruction;

4. Competition Rule 4A.4.4(1) relevantly provided:

(1) Subject to subrule (2), a Participant that operates a Crossing System must permit a client or other user of the Crossing System to opt out of having its Orders sent to the Participant's Crossing System (including any other Crossing System that may be accessible through the Participant's Crossing System), and the Participant must not impose on a user that opts out any additional operational or administrative requirements as a consequence of opting out of the Crossing System.

5. Chi-X Rule 3.3.1(b) relevantly provided:

A Market Participant must not:

...

- (b) enter into a Market Transaction for a Client, except in accordance with the instructions of the Client ...

6. On the following dates, Standing Instructions were given by five wholesale clients ("First Clients") to MLEA excluding the execution of Orders by MLEA on certain venues:

- (a) On 16 December 2013, Client 1 gave Standing Instructions to MLEA excluding the execution of Orders on Chi-X;
- (b) On 17 February 2015, Client 2 gave Standing Instructions to MLEA excluding the execution of Orders on Chi-X;
- (c) On 17 December 2013, Client 3 gave Standing Instructions to MLEA excluding the execution of Orders on Chi-X;
- (d) On 27 January 2015, Client 4 gave Standing Instructions to MLEA excluding the execution of Orders through MLEA's proprietary crossing system, **MLXN**; and
- (e) On 11 June 2014, Client 5 gave Standing Instructions to MLEA excluding the execution of Orders on Chi-X and through MLXN.

7. Notwithstanding those instructions, between July 2014 to 11 June 2015 ("First Relevant Period"), MLEA executed:
 - (a) 1 Order by Client 1 on Chi-X;
 - (b) 44 Orders by Client 2 on Chi-X;
 - (c) 524 Orders by Client 3 on Chi-X;
 - (d) 1,000 Orders by Client 4 through MLXN; and
 - (e) 435 Orders by Client 5 on Chi-X and through MLXN.
8. This failure to comply with ongoing Standing Instructions from the First Clients ("First Conduct") was reported by MLEA to ASIC on 11 September 2015 in the First Letter.
9. The First conduct was identified by MLEA as a result of a "Best Execution and Opt-Out Review" conducted by MLEA's Compliance and Technology teams dated July 2015 ("July 2015 Review").
10. Prior to the July 2015 Review and after the start of the First Relevant Period, the following reviews by MLEA failed to identify the First Conduct:
 - (a) September 2014, a Best Execution and Opting-Out Review conducted by MLEA's Compliance and Technology team; and
 - (b) November 2014, an MLEA Crossing System Compliance Review.
11. After ASIC received the First Letter, ASIC sent MLEA a warning letter dated 16 November 2015 ("Warning Letter") in relation to the First Conduct. In that letter, ASIC noted that MLEA had taken remedial action, advised MLEA that it had decided not to take action at the present time and reserved its right to do so if future conduct raised further issues of concern.
12. On the following dates, the following seven wholesale clients ("Second Clients") gave Standing Instructions to MLEA, excluding the execution of Orders against MLEA, or its related bodies corporate, as Principal when those Orders were to be executed through MLXN:
 - (a) Client 6 on 12 September 2014;
 - (b) Client 7 on 28 August 2015;
 - (c) Client 8 on 8 October 2014;
 - (d) Client 9 on 24 February 2015;
 - (e) Client 10 on 12 September 2014;

- (f) Client 11 on 12 September 2014; and
 - (g) Client 12 on 12 September 2014.
13. Between 12 September 2014 and 20 April 2016 ("Second Relevant Period"), MLEA executed:
- (a) 613 Orders by Client 6 through MXLN against MLEA as Principal;
 - (b) 2,878 Orders by Client 7 through MXLN against MLEA as Principal;
 - (c) 3,555 Orders by Client 8 through MXLN against MLEA as Principal;
 - (d) 827 Orders by Client 9 through MLXN against MLEA as principal;
 - (e) 11,364 Orders by Client 10 through MLXN against MLEA as principal;
 - (f) 25 Orders by Client 11 through MLXN against MLEA as principal; and
 - (g) 7,892 Orders by Client 12 through MLXN against MLEA as principal.
14. This conduct ("Second Conduct") was reported to ASIC by MLEA in the Second Letter. The Second Conduct was initially identified by Client 11, not by MLEA.
15. Prior to this notification by Client 11 and after the start of the Second Relevant Period, the following reviews by MLEA failed to identify the Second Conduct:
- (a) September 2014, a Best Execution and Opting-Out Review Conducted by MLEA's Compliance and Technology teams;
 - (b) November 2014, an MLEA Crossing System Compliance Review;
 - (c) July 2015, a Best Execution and Opting-Out Review conducted by MLEA's Compliance and Technology teams;
 - (d) October 2015, a Best Execution and Opting-Out Review conducted by MLEA's Compliance and Technology teams;
 - (e) November 2015, Crossing Systems Outages;
 - (f) January 2016, a Best Execution and Opting-Out Review conducted by MLEA's Compliance and Technology teams; and
 - (g) 9 May 2016 (test period March 2016), Confirmations to Non-Retail Clients Review conducted by MLEA's Compliance and Technology teams.
16. The MDP has reasonable grounds to believe that MLEA contravened:

- (a) Competition Rules 3.1.1(4) – Best Execution Opt Out Rule – by failing to comply with the respective Standing Instructions of the First Clients and the Second Clients to Opt Out of the Best Execution Rule;
- (b) Competition Rule 3.1.1(5)(a) – Periodic Review of Opt Out Instructions Rule – by failing to conduct periodic reviews to ensure that it could satisfactorily comply with the Client’s opt-out instructions;
- (c) Competition Rule 4A.4.4(1) – Crossing System Opt Out Rule – by failing effectively to permit two of the First Clients to opt out of the MLEA crossing system; and
- (d) Chi-X Rule 3.3.1(b) – Client Instruction Rule – by entering into transactions on Chi-X on behalf of four Clients without the instructions to do so;

and thereby contravened subsection 798H(1) of the Act in respect of the conduct described above.

17. The penalties payable under this infringement notice for the four alleged contraventions of subsection 798(H)(1) of the Act are as follows:

- (a) by reason of contravening Competition Rule 3.1.1(4) – \$70,000;
- (b) by reason of contravening Competition Rule 3.1.1(5)(a) – \$20,000;
- (c) by reason of contravening Competition Rule 4A.4.4(1) – \$10,000; and
- (d) by reason of contravening Chi-X Rule 3.3.1(b) – \$40,000.

18. The total penalty payable is **\$140,000**.

19. In considering this matter and the appropriate penalty, the MDP commented:

- (a) The seriousness of the failure to comply with the Standing Instructions of the Clients was compounded by the fact that MLEA had received a Warning Letter from ASIC in relation to the First Conduct. MLEA was on notice and should have been in a position to detect and avoid the Second Conduct, which was allowed to continue for a further seven months.
- (b) While MLEA conducted regular periodic internal reviews, these were not sufficiently thorough or appropriate in the context of MLEA's complex systems. The internal reviews failed to ensure that it could, in fact, comply with its client’s instructions. More complex systems require more complex review processes not necessarily more regular reviews.
- (c) Remediation after identifying the First Conduct must be relative to the scale and complexity of the operation. While an obligation on MLEA to review all client instructions would have been onerous, in the context of the scale and complexity of MLEA's business, this obligation was appropriate.
- (d) While an MLEA internal review did pick up the First Conduct after a period of time, the Second Conduct was detected by a client of MLEA.

- (e) MLEA made a commercial decision to run multiple operating systems and offer a premium service in the market. MLEA was therefore under an obligation to make the necessary investment in compliance to ensure those systems work as intended.
- (f) MLEA's conduct was careless and there is no suggestion that MLEA intended to mislead its Clients.
- (g) A compounding factor was MLEA's general history of non-compliance with the Market Integrity Rules.
- (h) The conduct of MLEA has been commendable in relation to the Markets Disciplinary Panel. MLEA self-reported the breaches and their approach and provision of information in response to the allegations has been highly effective. This conduct is a mitigating factor.

No adverse finding

20. The MDP also made a finding that it did not have reasonable grounds to believe that MLEA contravened Chi-X Rule 5.5.2(b).

21. Chi-X Rule 5.5.2(b) relevantly provided:

A Market Participant must have and maintain the necessary organisational and technical resources to ensure that:

- (a) ...
- (b) the Market Participant complies at all times with these Rules and the Market Operating Rules.

22. The MDP considers that Chi-X Rule 5.5.2(b) should be reserved for systemic organisational and technical issues. MLEA had organisational and technical capability but isolated errors or omissions by individuals were the primary cause of the non-compliance with the Rules.

Other information

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

- by reason of contravening Competition Rule 3.1.1(4) – \$1,000,000;
- by reason of contravening Competition Rule 3.1.1(5)(a)– \$1,000,000;
- by reason of contravening Competition Rule 4A.4.4(1) – \$100,000; and
- by reason of contravening Chi-X Rule 3.3.1(b) \$1,000,000.

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 3.1.1(4) – \$600,000;
- by reason of contravening Competition Rule 3.1.1(5)(a)– \$600,000;
- by reason of contravening Competition Rule 4A.4.4(1) – \$60,000; and

- by reason of contravening Chi-X Rule 3.3.1(b) \$600,000.

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

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

MLEA 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.



David Dworjanyn

Senior Manager, Chief Legal Office

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.