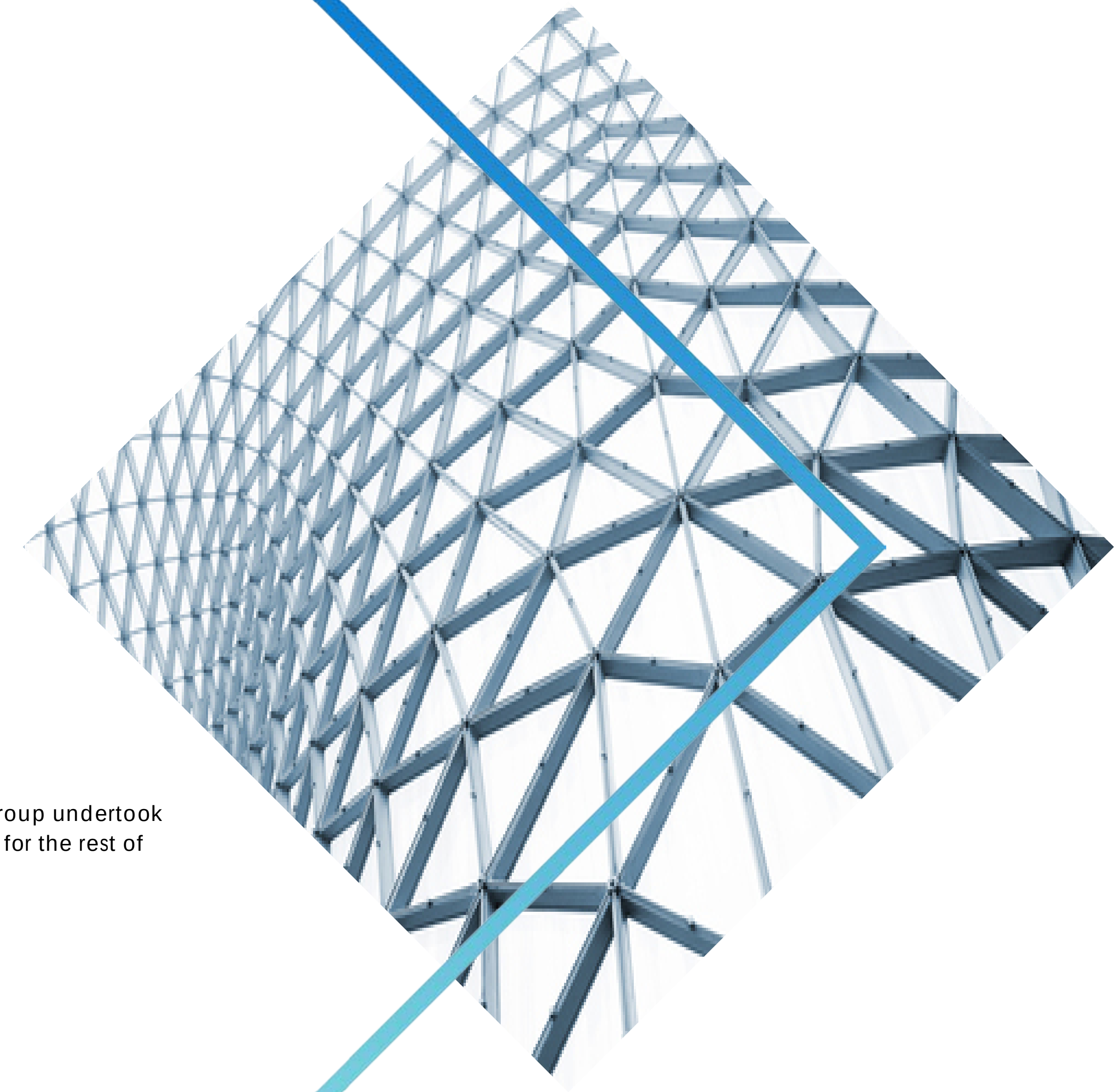
Market integrity report: January to June 2018

Report 599 | November 2018



About this report

This report highlights some of the activities the Market Integrity Group undertook between 1 January and 30 June 2018, and includes our priorities for the rest of the year.

Market Integrity Group – six months at a glance

Overview

ASIC's vision is for a fair, strong and efficient financial system for all Australians.

We are driving the integrity, confidence and innovation of Australian markets so firms can thrive and investors can participate with confidence.

We will identify the most significant harms to consumers, investors and markets. Where we identify misconduct, we will take regulatory action.

Criminal actions

- **2** people charged in criminal proceedings
- **200** criminal charges laid against 2 people
- **1** sentenced (released immediately upon recognisance) to 1 year, 9 months imprisonment

Civil outcomes

- **$5** million in civil penalties
- **1** court enforceable undertaking
- **$95,000** in community benefit payments

Bannings and infringement notices

- **1** infringement notice issued
- **$35,000** in infringement notices paid
- **1** person banned from providing financial services

Standards and education

We look closely at the effect of different behaviours on our markets. Our observations inform the standards we set and how we educate our stakeholders.

Exchange traded products

We published new guidance for licensed exchanges seeking to admit exchange traded products (ETPs) to their market. Information Sheet 230 *Exchange traded products: Admission guidelines* largely reflects our existing expectations and current market practice, and sets out clear and consistent standards for the admission of ETPs including managed funds, exchange traded funds and structured products.

ASIC and ASX have also agreed on an admission process for ETPs on ASX – with ASX taking full responsibility for the day-to-day admission process.

Client money

We released updated guidance for Australian financial services (AFS) licensees that hold client money. This updated guidance is particularly important for licensees that trade in over-the-counter (OTC) derivatives.

The changes mean that AFS licensees can no longer withdraw derivative retail client money from the client money account and use it for a wide range of purposes, including as the licensee's own working capital.

The reforms also impose new record-keeping, reconciliation and reporting requirements on AFS licensees that hold derivative retail client money.

> “The amendments to the client money regime enacted by Parliament have strengthened the protection of derivative retail client money and will help to increase investor confidence in the Australian financial system.”
>
> **Cathie Armour** | ASIC Commissioner

Significant financial benchmarks

The final stage in a new comprehensive regulatory regime for financial benchmarks occurred when we finalised benchmarks rules, made a significant benchmarks declaration, and issued an associated regulatory guide.

This follows the implementation of a new bank bill swap rate (BBSW) methodology in May, with the benchmark now calculated directly from market transactions during a longer rate-set window and involving a larger number of participants.

The actions taken by ASIC include:

- declaring certain financial benchmarks to be significant
- writing rules to support the implementation of a licensing regime for the administrators of significant benchmarks

- allowing ASIC to, by written notice, require the continued administration of a significant benchmark or compel submissions to a significant benchmark.

Credit rating agencies

We made a number of recommendations for change following a market-wide surveillance of credit rating agencies (CRAs) operating in Australia.

The focus areas of our surveillance included CRAs' governance arrangements (including conflicts of interest and corporate structure), transparency and disclosure.

Report 566 *Surveillance of credit rating agencies* made a number of observations about CRAs' activities with some leading to recommendations for change in areas such as board reporting, compliance teams and compliance testing, analytical evaluation of ratings and human resources.

Market licensing regime

We released updated and modernised guidance on the licensing regime for financial markets.

Regulatory Guide 172 *Financial markets: Domestic and overseas operators* (RG 172) will introduce a two-tiered market licensing regime. The new approach will create a more tailored regulatory regime, providing flexibility and helping to facilitate the operation of specialised and emerging markets – while ensuring that Australia's financial markets meet the highest international standards of regulation. The changes were widely supported during our extensive consultation with industry.

As outlined in RG 172, we will now determine if each market venue should be designated as tier 1 or tier 2 using a risk-based assessment.

Tier 1 market venues are, or are expected to become, significant to the Australian economy or the efficiency and integrity of, and investor confidence in, the financial system. Tier 2 licences will be able to facilitate a range of market venues, including specialised and emerging market venues.

Market integrity rules

We released two consolidated guides for securities and futures market participants, making it easier to find what you need.

- Regulatory Guide 265 *Guidance on ASIC market integrity rules for participants of securities markets*
- Regulatory Guide 266 *Guidance on ASIC market integrity rules for participants of futures markets*.

As part of this process we:

- merged guidance where appropriate and made minimal changes necessary to reflect updated market integrity rule references as contained in the consolidated rulebooks
- removed information that is purely descriptive or no longer relevant
- introduced new guidance on management structures
- tailored some information to make it market neutral or, where necessary, more appropriately relate to relevant markets.

Behavioural change

Achieving behavioural change is an important part of our work. By changing behaviour, we may be able to avoid future instances of risky conduct and breaches, and prevent investor losses before they occur.

Investor warnings

We warned investors not to deal with AGM Markets Pty Ltd, OT Markets Pty Ltd and Ozifin Tech Pty Ltd in relation to trading in margin FX (foreign exchange), contracts for difference (CFDs) and bitcoin CFDs, following concerns they were offering advice not authorised by their AFS licences and engaging in conduct that was misleading and deceptive.

We also obtained an interim injunction against the three companies to protect investors' funds while we conducted our investigation.

Misleading or deceptive conduct in ICOs

We are targeting misleading or deceptive conduct in the marketing and selling of digital or virtual tokens via initial coin offerings (ICOs), as it is prohibited under both the Australian Consumer Law and the *Australian Securities and Investments Commission Act 2001*.

We are issuing inquiries to ICO issuers and their advisers where we identify conduct or statements that may be misleading or deceptive following a delegation from the Australian Competition and Consumer Commission. This is in addition to any inquiries where we identify potentially unlicensed conduct. As a result of our inquiries, some issuers halted their ICO or indicated the ICO structure will be modified.

> “If you are acting with someone else's money, or selling something to someone, you have obligations. Regardless of the structure of the ICO, there is one law that will always apply: you cannot make misleading or deceptive statements about the product. This is going to be a key focus for us as this sector develops.”
>
> **John Price** | ASIC Commissioner

Retail OTC derivatives

Issuers in the retail OTC derivatives sector were advised to improve their practices after our review found their conduct fell short of expectations.

Our recent activities identified many risks associated with the products offered to retail investors by OTC derivatives issuers. These products include binary options, CFDs and margin FX.

Our review found that client losses in retail OTC derivatives trades seemed high, with the percentage of unprofitable traders being up to 80% for binary options, 72% for CFD traders and 63% for margin FX traders.

We expect licensed issuers to conduct themselves appropriately and ensure consumers trade in retail OTC derivatives with a clear understanding of the products and the risks to which they're exposed. We will continue to take action to raise industry standards and improve compliance with their AFS licence obligations.

Binary options campaign

We launched a consumer warning campaign, alerting consumers to the riskiness of investing in binary options.

Our review of the retail OTC derivatives sector identified binary options as:

- the highest contributor to consumer losses
- the least transparent in terms of underlying pricing, strike price rates and payout structures.

Our animation released through social media and our MoneySmart website has been viewed over 4,000 times. We also updated the register of companies consumers should not deal with to include unlicensed binary option providers.

Disruption

> **Poor conduct harms our financial system and results in adverse consumer outcomes. Where we see poor conduct, we will take action.**

Financial benchmarks misconduct

Financial benchmarks are critical to market integrity because they are used as the reference price for a wide range of financial products. Manipulation of benchmarks can undermine their reliability and damage trust and confidence in Australia's financial markets.

Until the new methodology for the BBSW was implemented in May (as outlined on page 3), the BBSW represented the midpoint of the nationally observed best bid and best offer (NBBO) for ASX Prime Bank Eligible Securities. In early 2018, we commenced legal proceedings in the Federal Court against the Commonwealth Bank of Australia (CBA), alleging unconscionable manipulation in relation to their involvement in setting the BBSW in 2012.

The Federal Court imposed pecuniary penalties of $5 million on CBA on 21 June 2018, for attempting to engage in unconscionable conduct in relation to the BBSW. In imposing the penalties, the court noted the terms of the court enforceable undertaking, where CBA will pay $15 million towards the benefit of the community and $5 million towards our investigation and legal costs. CBA will also engage an independent expert to assess changes made to its policies and procedures in relation to Prime Bank Bills trading.

> “CBA’s conduct was engaged in for the purpose of profiting CBA in circumstances where CBA knew that if successful, it may have gained at the expense of others who were vulnerable.”

Justice Beach | Federal Court

On 24 May 2018, the Federal Court found that Westpac engaged in unconscionable conduct in breach of the *ASIC Act* by its involvement in setting the BBSW on four occasions over the period from 6 April 2010 to 6 June 2012. On these occasions, the court found Westpac traded with the dominant purpose of influencing yields of traded Prime Bank Bills and setting the BBSW in a way that was favourable to its rate-set exposure.

The court also found that Westpac had breached its obligations as an AFS licensee under s912A of the *Corporations Act 2001* by failing to have adequate procedures and training in place.

Unauthorised data access and insider trading

New South Wales IT consultant, Steven Oakes, was originally charged with 115 offences for unauthorised access to data held in a computer, insider trading, and destroying or concealing books required by ASIC.

We alleged that between January 2012 and February 2016, Mr Oakes gained unauthorised access to inside information from a private financial publisher’s computer network, and on 70 occasions used this information to buy shares in 52 ASX-listed companies before the ‘buy’ recommendations for the shares in those companies were published. He made profits from selling the shares a short time later, following the reports’ publication.

Mr Oakes will appear for plea at the County Court in Melbourne on 15 March 2019.

Market manipulation

On 4 April 2018, the District Court of South Australia sentenced Stefan Boitcheff to one year and nine months imprisonment after he pleaded guilty to two market manipulation related charges.

Our investigation into Mr Boitcheff’s trading in CFDs found that between 3 January 2013 and 16 July 2013, he carried out 112 transactions in CFDs relating to Anteo Diagnostics Limited (ADO) shares, which had the effect of creating an artificial price for the trading of these shares on ASX. He also carried out four transactions in ADO CFDs and ADO shares between 8 May 2013 and 7 January 2014, which had the effect of creating a false or misleading appearance of active trading in ADO shares on ASX.

Mr Boitcheff was released immediately upon entering into a recognisance to be of good behaviour for two years.

What's next?

We will focus on the following existing and emerging risks during the remainder of the year.

1. **Conduct** – we are enhancing our supervision of the highest-risk firms, with a greater focus on governance, and the systems and controls that prevent poor conduct. Our focus includes fixed income, commodities and currencies, retail OTC derivative providers, ICOs and client money.

2. **Technology risk and resilience** – our focus is on poor technological controls, including for cyber security and the use of artificial intelligence. We support the opportunities and economic benefits of innovation in financial markets, while managing the risks.

3. **Effective capital markets** – we are reviewing high-frequency trading in FX markets, retesting the cleanliness of our markets and continuing to enhance our market integrity rules.

Read the Market Integrity Group's strategic priorities 2018–19 for more information about each of these priorities.

For regular updates on the markets work ASIC is doing, subscribe to our monthly Market Integrity Update.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents: consultation papers, regulatory guides, information sheets and reports.

Disclaimer

This report does not constitute legal advice. We encourage you to seek your own professional advice to find out how the Corporations Act and other applicable laws apply to you, as it is your responsibility to determine your obligations.
Examples in this report are purely for illustration; they are not exhaustive and are not intended to impose or imply particular rules or requirements.