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Contents

Markets Disciplinary Panel: Infringement Notice

Recipient: Finclear Execution 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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ASIC
Australian Securities &
Investments Commission



PART 7.2A OF THE CORPORATIONS REGULATIONS 2001

INFRINGEMENT NOTICE

To: Finclear Execution Limited ACN 061 751 102

Matter: MDP 328/19

Date given: 11 July 2019

TAKE NOTICE: The Australian Securities and Investments Commission (“ASIC”) gives this infringement notice to Finclear Execution Limited (“Finclear”) under regulation 7.2A.04 of the *Corporations Regulations 2001* (“the Regulations”), which is made for the purposes of section 798K of the *Corporations Act 2001* (“the Act”).

To comply with this notice Finclear must pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **\$70,000**.

Background

1. This matter concerns transactions carried out over two days as part of an on-market buy-back on behalf of a company listed on ASX Limited, in particular:
 - (a) on the first day—a transaction for 4,165,656 shares at \$2.50 effected by way of a “special crossing”, and the subsequent cancellation of that transaction after the close of trading on the same day;
 - (b) on the second day—a transaction on behalf of the same underlying clients for the same number of shares at the same price in circumstances where:
 - (i) a cum-dividend market had been established to replicate the dividend rights attached to the shares that existed on the previous day; and
 - (ii) Finclear relied upon the instructions of the underlying clients from the previous day.
2. The transaction was significant in the context of the on-market buy-back. The transaction represented approximately 87% of the remaining shares that the listed company was offering to buy back. The transaction also represented approximately 8% of the issued capital of the listed company.

On-market buy-backs

3. A “buy-back” by a company means the acquisition by the company of shares in itself: section 9 of the Act. An “on-market buy-back” means a buy-back by a listed corporation on a prescribed financial market in the ordinary course of trading on the market: see section 9 of the Act. Both ASX Limited and Chi-X Australia Pty Ltd are a “prescribed financial market”: see regulation 1.0.02A of the Regulations. This definition applies for the purposes of the market integrity rules.
4. Neither the Act nor the market integrity rules define the meaning of the expression “ordinary course of trading”. *ASIC Regulatory Guide 110: Share buy-backs* states:

RG 110.61 In Australia, this phrase means that the trading is in strict order of price and time priority, with indifference as to the identity of counterparties, and no pre-arrangements or selection of counterparties: see *Attorney-General (Vic) v Walsh’s Holdings Ltd* [1973] VR 137.

5. The MDP considers Regulatory Guide 110.61 to correctly reflect the law and the prevailing market practice as to the meaning of “ordinary course of trading”.

Special crossing

6. A special crossing, in this context, refers to a block trade that was entered into other than by matching of orders on an order book of an equity market: see Rule 1.4.3 of the *ASIC Market Integrity Rules (Chi-X Australia Market) 2011* (“the Chi-X Rules”) and the *ASIC Market Integrity Rules (ASX Market) 2010* (“the ASX Rules”).

Details of the alleged contraventions

7. The MDP was satisfied that, by March 2018, the listed company engaged an authorised representative of a financial services licensee to act on the listed company’s behalf to buy back up to 4.8 million shares under an on-market buy-back, and that representative had in turn engaged Finclear, a Market Participant who had access to the Trading Platform, to carry out the on-market buy-back.
8. The MDP was satisfied that, on 16 April 2018, the following events occurred:
 - (a) 11.04 – 11.08 am: the authorised representative indicated to Finclear that it had found a seller that was prepared to sell 4,165,656 shares into the buy-back at a price of \$2.50, instructing Finclear to “cross” the proposed sale, indicating that the buyer was the company conducting the buy-back. Finclear did so and reported the transaction as a special crossing to Chi-X for that volume and price;
 - (b) 4.28 – 5.14 pm: after the close of the market for the day, the authorised representative contacted Finclear querying why the transaction was reported as a special crossing. Finclear’s Head of Execution Services initially responded to the representative indicating that Finclear’s Compliance Team was satisfied that there was no restriction on placing a special crossing under an on-market buy-back. Shortly thereafter, Finclear’s Compliance Manager contacted the representative indicating that, after reviewing ASIC’s Market Supervision Update, Finclear were now of the view that a special crossing was not permitted;

- (c) 6.00 – 6.50 pm: Finclear contacted ASIC informing them of the special crossing. ASIC indicated that a special crossing was generally not permitted and that Finclear should obtain legal advice about whether the special crossing needs to be cancelled. Finclear subsequently cancelled the special crossing.
 - (d) 7.10 pm: the authorised representative sent an email to the listed company indicating that “[t]he guys at Finclear have not entered the trade into the market correctly” and that “[t]he trade will be re-entered first thing tomorrow morning – the sale stands – it’s just the settlement date will be bumped by a day”.
9. The MDP was satisfied that, on 17 April 2018, the following events occurred:
- (a) 8.32 - 8.51 am: before the opening of the market and at Finclear’s request, ASX established a special cum-dividend market for the shares of the listed company conducting the buy-back. The request was made because the market for the shares went ex-dividend on that day;
 - (b) 9.50 - 10.45 am: conversations occurred between Finclear and ASIC in relation to the cancelled transaction, and its proposed re-execution. ASIC had suggested that, to allow other participants an equal opportunity to sell into the buy-back, the Bid might need to be placed in the market for “hours, [half] a day as opposed to minutes or seconds”. Finclear indicated to ASIC that “nowhere does it say how long the order needs to sit in [the market]”;
 - (c) 10.32 - 10.51 am: Finclear attempted some price discovery in the cum-dividend market by entering a Bid (\$2.45) and Ask (\$2.55) for 5,000 shares, which was subsequently amended to a Bid (\$2.48) and Ask (\$2.52) for 5,000 shares. Finclear cancelled the Bid and entered a new Bid for 5,000 shares at \$2.50. None of these orders resulted in a transaction;
 - (d) 10.51 am: Finclear entered a Bid for 4,165,656 at a price of \$2.50 and, 7 seconds later, Finclear entered an Ask at the same volume and price. The Ask immediately matched with the Bid on the Trading Platform of the ASX.
10. The market integrity rules alleged to have been contravened are:
- (a) Rules 3.3.1(b), 5.5.2 and 5.9.1 of the Chi-X Rules;
 - (b) Rule 5.9.1 of the ASX Rules; and
 - (c) Rule 3.1.1(1) of the *ASIC Market Integrity Rules (Competition in Exchange Markets) 2011* (“the Competition Rules”).
11. The MDP made adverse findings and specified penalties in relation to two of the alleged contraventions. The MDP made no adverse findings in relation to the remaining three alleged contraventions.

Adverse findings

Obligation to act in accordance with client instructions

12. Chi-X Rule 3.3.1(b) relevantly states:

A Market Participant must not: ...

- (b) enter into a Market Transaction for a Client, except in accordance with the instructions of the Client, or of a person authorised in writing by a Client to give such instructions ... or as otherwise permitted by these Rules or the Market Operating Rules.
13. The MDP is satisfied that the listed company (“the buy-back client”), through the authorised representative who notified the ASX that it was acting on behalf of the underlying buy-back client, gave instructions to Finclear to conduct an on-market buy-back on its behalf. An on-market buy-back must be in the ordinary course of trading. A transaction executed as a special crossing is not in the ordinary course of trading.
14. As Finclear executed the transaction on 16 April 2018 on behalf of the buy-back client as a special crossing, the MDP considers that Finclear did not enter into the transaction in accordance with the buy-back client’s instructions. At the request of Finclear, after having realised the error, the special crossing was cancelled on the same day after the close of the market. Despite the remedial steps taken to cancel the special crossing, the MDP considers the contravention of Chi-X Rule 3.3.1(b) had already occurred.

The pre-arranged re-execution of the crossing

15. ASX Rule 5.9.1 states:

A Market Participant must not do anything which results in a market for a Product not being both fair and orderly, or fail to do anything where that failure has that effect.

16. The MDP has reasonable grounds to believe that the crossing on 17 April 2018 in the cum-dividend market created by ASX for the shares was an act that resulted in the market for the shares not being both fair and orderly in contravention of ASX Rule 5.9.1 for the following reasons:
- (a) the Bid and Ask entered into the Trading Platform was a pre-arranged scheme devised by Finclear or by the authorised representative, acting in concert with each other, to re-create the cancelled special crossing on 16 April 2018. The email sent at 7.10 pm on that day by the representative to the listed company supports the finding of pre-arrangement: “[t]he guys at Finclear have not entered the trade into the market correctly” and “[t]he trade will be re-entered first thing tomorrow morning – the sale stands – it’s just the settlement date will be bumped by a day”;
 - (b) a transaction that occurs in relation to an on-market buy-back conveys the representation to the market that, absent a representation to the contrary (e.g. the transaction being reported as a special crossing), the transaction occurred in the ordinary course of trading with indifference as to the identity of counterparties and without any pre-arrangement. Finclear conveyed that

representation by entering the Bid and Ask into the Trading Platform as a normal crossing. That representation was misleading.

No adverse findings

17. The MDP considered but made no adverse findings against Finclear in relation to alleged contraventions of the following market integrity rules:
- (a) in respect of the special crossing on 16 April 2018—Chi-X Rule 5.5.2;
 - (b) in respect of the special crossing on 16 April 2018—Chi-X Rule 5.9.1;
 - (c) in respect of the conduct between 16 - 17 April 2018—Competition Rule 3.1.1.

Obligation to maintain necessary organisational and technical resources

18. Chi-X Rule 5.5.2 relevantly states:

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

- (a) Trading Messages submitted by the Market Participant do not interfere with:
 - (i) the efficiency and integrity of the Chi-X Market ...; and
 - (b) the Market Participant complies at all times with these Rules and the Market Operating Rules.
19. The Designated Trading Representative (“the DTR”) that executed the trade was not aware that a special crossing was not permitted. The Compliance Manager and the Head of Execution Services, at least initially, were under the same misapprehension. Once the misapprehension became known to Finclear, which was on the same day but after the close of the market, Finclear took steps to cancel the special crossing.
20. The issue had arisen as a result of a lack of knowledge of the persons occupying these positions, who should have been aware of the restrictions on special crossings for buy-backs. However, as it was an isolated mistake, albeit a significant one in the context of the buy-back, it falls short of demonstrating that Finclear itself contravened Chi-X Rule 5.5.2.
21. The MDP considers that Rule 5.5.2 is concerned with organisational competency. Organisational competency is to be assessed having regard to the quantity and quality of the systems and staff of the Market Participant, including how those systems and staff interact to ensure market integrity. While the rule is directed at ensuring that a Market Participant can discharge the obligation to comply with the market integrity rules, it is not a rule that demands zero failure on every occasion.

Special crossings and fair and orderly markets

22. Chi-X Rule 5.9.1 states:

A Market Participant must not do anything which results in a market for a Cash Market Product not being both fair and orderly, or fail to do anything where that failure has that effect.

23. A special crossing is a transaction executed other than on the market—there is no Bid or Ask entered into an order book or matched on a Trading Platform. A special crossing, by its very nature, excludes other participants, and need not bear any relation to the market price of the shares or the Bid / Ask spread at the relevant time. A special crossing is however required to be reported to the market operator as a special crossing.
24. The MDP notes the findings in *Rosenberg v ASIC* [2010] AATA 654 where the Administrative Appeals Tribunal (“the AAT”) found that the special crossings under consideration in that matter did not create a false or misleading appearance of active trading within section 1041B of the Act. The AAT found that special crossings are not the product of normal trading on the market and can take place at any agreed price.
25. The MDP considers that a special crossing, even one executed in circumstances not permitted by the market integrity rules or the Act, does not necessarily cause a market to be unfair or disorderly. The special crossing reflected genuine supply and demand. It was truthfully reported to the market operator as a special crossing and consequently cancelled once noted to be impermissible within the on-market buy-back.

Reasonable steps to achieve best outcome for client

26. Competition Rules 3.1.1(1) and (2) relevantly state:

- (1) [When] handling and executing an Order for a client a Participant must take reasonable steps to obtain the best outcome for that client.
- (2) For the purposes of subrule (1), when handling and executing an Order for: ...
 - (b) a Wholesale Client who has not given an instruction under subrule (4), the best outcome may be price, costs, Total Consideration, speed, likelihood of execution or any other relevant outcome, or any combination of those outcomes.

27. Despite the unusual circumstances of this matter, the MDP considers that Finclear did take reasonable steps to obtain the best outcome for the buyer and the seller, each being Wholesale Clients, when handling and executing their respective orders.
28. The buyer and seller were well placed to determine their best outcome respectively. Both Wholesale Clients, through their adviser, instructed Finclear that a crossing be executed at an agreed price and volume which gave confidence of a likely outcome. Finclear also arranged for the creation of a special cum-dividend market in the class of shares to facilitate the crossing on 17 April 2018 to replicate the agreed transaction that was impermissibly executed as a special crossing on the previous day (but which was subsequently cancelled).

29. The outcome sought by both clients was in fact achieved, albeit a day later, and despite the instructions being carried out in a way that the MDP considers contravened other market integrity rules.

Penalty

30. The MDP considers the following penalties are appropriate:
- (a) \$20,000—for the adverse finding in relation to Chi-X Rule 3.3.1(b);
 - (b) \$50,000—for the adverse finding in relation to ASX Rule 5.9.1.
31. The respective penalties are in the low range relative to the maximum penalties that could have been specified for the alleged contravention of the respective rules.
32. The key mitigating factors were that this was an isolated transaction by a market participant who has no previous adverse disciplinary history before the MDP. The key aggravating factor is that the pre-arranged transaction represented a significant amount of the buy-back volume on offer, which excluded other participants.
33. The MDP characterises the conduct in relation to the special crossing as careless. Finclear knew the underlying buy client was conducting an on-market buy-back. The DTR failed to take reasonable care in executing the crossing. Finclear's systems or post-trade controls did not identify the issue. The Compliance Manager, at least initially, failed to appreciate that special crossings within a buy-back are not permitted. The Head of Execution Services appeared to be under a similar misapprehension. There was a failure to take reasonable care across different levels of implementation and oversight.
34. The penalty of \$20,000 for the alleged contravention of Chi-X Rule 3.3.1(b) is broadly consistent with the penalties specified in **MDP 806/18** – October 2018 (UBS Securities). That matter involved Trades with Price Improvement which, although not special crossings, are also not permitted in relation to on-market buy-backs. The MDP similarly characterised the conduct in that matter as being careless.
35. The MDP does not consider that there is any previous matter from which the MDP can be usefully guided as to the appropriate penalty in relation to the subsequent crossing. The MDP considers Finclear's conduct to be intentional as to the outcome it sought to achieve, but it does not consider that Finclear intended to contravene the rules.
36. The MDP considers the conduct in relation to the subsequent crossing to be more serious than the careless conduct in relation to the special crossing. Finclear was mindful it may have the previous day breached its obligations in Chi-X Rule 3.3.1(b). It had the opportunity to carefully consider the significant percentage of the buy-back it was seeking to cross as against the plan to again execute the desired crossing but in the cum-dividend market so as to fulfil the clients' original instructions.
37. Finclear was in a bind between its obligations under the rules and to its clients. It did not appear that the unpalatable solution may have been not to act on its clients' original instructions, because of the pre-arrangement between those clients. Finclear was also aware of ASIC's expectations as conveyed in conversations between ASIC and

Finclear in the lead up to the subsequent crossing that the offer be held in the market for a prolonged period of time. This would not have cured the pre-arranged nature of the transaction but if the offer had been made for an extensive period of time, it would have dispelled the proposition that there was any unfairness. Finclear was not obliged to meet ASIC's expectations, but it voluntarily assumed the risk of not doing so.

38. While the MDP considers that Finclear's conduct resulted in the market for the shares not being fair, it considers the degree of unfairness to be at the lower end of the scale. The pre-arranged transaction represented a significant amount of the buy-back volume on offer, however this is significantly countered by the fact that the market for the shares at the relevant time was relatively illiquid.
39. The specified penalty must have a sufficient deterrent effect on Finclear and other participants who are conducting on-market buy-backs for their clients. Finclear may also have caused the buy-back client to contravene the Act because a pre-arranged transaction is not in the ordinary course of trading. Transactions that are pre-arranged are not acceptable for on-market buy-backs.
40. The MDP considers a penalty of \$50,000 for the alleged contravention of ASX Rule 5.9.1 is appropriate for the subsequent crossing.

Other information

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

- by reason of contravening Chi-X Rule 3.3.1(b)—\$1 million;
- by reason of contravening ASX Rule 5.9.1—\$1 million.

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 Chi-X Rule 3.3.1(b)—\$600,000;
- by reason of contravening ASX Rule 5.9.1—\$600,000.

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

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

Finclear may apply to ASIC for the 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

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.