



ASIC
Australian Securities &
Investments Commission

Commonwealth of Australia Gazette

MDP06/23, Wednesday 6 December 2023

Published by ASIC

ASIC Gazette

Contents

Markets Disciplinary Panel: Infringement Notice

Recipient: Instinet Australia Pty Ltd

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*.

ISSN 1445-6060 (Online version)
ISSN 1445-6079 (CD-ROM version)

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ASIC
Australian Securities &
Investments Commission



PART 7.2A OF THE CORPORATIONS REGULATIONS 2001 INFRINGEMENT NOTICE

To: Instinet Australia Pty Ltd
ACN 131 253 686
Level 41, Governor Phillip Tower
1 Farrer Place
SYDNEY NSW 2000

Matter: MDP 0616/23

Date given: 23 October 2023

TAKE NOTICE: The Australian Securities and Investments Commission (**ASIC**) gives this infringement notice to Instinet Australia Pty Ltd ACN 131 253 686 (**Instinet**) 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, Instinet must pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **\$670,500**.

Background

1. Instinet is a wholly owned member of the Nomura group of companies. At all relevant times, Instinet was a market participant of the Markets operated by ASX Limited and Cboe Australia Limited (formerly Chi-X Australia Pty Ltd).
2. Instinet operated a crossing system called BLX Australia (**BLX crossing system**) from 1 April 2011 until it was suspended from operation by Instinet on 11 October 2022. Non-public crossing systems are often referred to as 'Dark Pools'.
3. In relation to the operation of the BLX crossing system, the MDP has reasonable grounds to believe that Instinet contravened:
 - a. Rule 4A.3.2 of the *ASIC Market Integrity (Competition in Exchange Market) Rules (Competition Rules)* and Rule 5A.2.2 of the *ASIC Market Integrity Rules (Securities Markets) 2017 (Rules)* (**first alleged contravention**);
 - b. Rule 6.1.1 of the Rules (**second alleged contravention**); and
 - c. Rule 7.4.2 of the Rules (**third alleged contravention**).

and therefore contravened subsection 798H(1) of the Act.

First Alleged Contravention – Rule 4A.3.2 and 5A.2.2

4. Rule 5A.2.2 of the Rules provides:

(2) A Market Participant that operates a Crossing System must:

- (a) prior to accepting an Order from a client for the first time;*
- (b) ...*

provide that client with a document containing the Non-Public Crossing System Information in relation to that Crossing System.

5. Rule 5A.2.2(5) provides that *Non-Public Crossing System Information* includes, in relation to Operations:

(c) the level of anonymity given to Orders, including whether indications of interest are allowed;

6. The obligation to disclose this information was introduced by Rule 4A.3.2 in the Competition Rules on 10 August 2013 and market participants were required to comply with this obligation from 10 February 2014. Due to the operation of transitional provisions, Rule 5A.2.2 of the Rules effectively replaced Rule 4A.3.2 of the Competition Rules on 7 May 2018.

7. ASIC Regulatory Guide 265 at RG265.305 states that it is important that clients of a market participant that operates a crossing system understand the operating procedures of the crossing system.

8. Instinet created a document, initially dated 6 February 2014, containing a set of procedures for the BLX crossing system called the BLX Australia Rulebook (***BLX Rulebook***). It stated that:

Indications of Interest (IOI's) are not currently used in BLX.

9. This statement in the BLX Rulebook remained unchanged from the first edition of the BLX Rulebook on 6 February 2014 until November 2022 when it was removed.

10. Notwithstanding this statement, from at least 6 February 2014, the BLX crossing system enabled users (principally algorithms) to indicate to Instinet their interest to trade. While these indications were not disseminated to, nor visible to, any other users, they were visible to Instinet, who would use them to build a prospective book for a matching process.

11. The MDP considered that the ability to submit indications of interest in the BLX crossing system comprised Non-Public Crossing System Information and should have been disclosed to clients under Rule 5A.2.2 of the Rules, and prior to that under Rule 4A.3.2 of the Competition Rules. The Panel determined that it is generally understood by Market Participants that allowing users to indicate their interest to trade, even if only visible to Instinet, falls within the term 'Indications of Interest' as contemplated by Rule 5A.2.2(5) of the Rules and Rule 4A.3.2 of the Competition Rules. The BLX

Rulebook made no disclosure of the fact that the BLX crossing system permitted these types of indications of interest and therefore Instinet was not being transparent about the use of indications of interest with clients.

12. The MDP considered that this conduct should be treated as a single course of conduct from 10 February 2014 to 11 October 2022.
13. For these reasons, the MDP considered that it had reasonable grounds to believe that Instinet breached Rule 4A.3.2 of the Competition Rules from 10 February 2014 to 6 May 2018 and Rule 5A.2.2 of the Rules from 7 May 2018 to 11 October 2022 by failing to disclose properly the level of anonymity given to orders provided by the BLX crossing system by failing to disclose that it enabled indications of interest for certain purposes.

Second Alleged Contravention – Rule 6.1.1

14. Rule 6.1.1 provides:

(1) Subject to subrule (2), a Relevant Participant must not enter into a transaction unless the transaction is entered into by matching of a Pre-Trade Transparent Order on an Order Book.

(2) A Relevant Participant is not required to comply with subrule (1) in relation to:

- (i) ...*
- (ii) a Trade with Price Improvement;*
- (iii) ...*

15. The Rules recognise that in certain circumstances, clients may benefit from receiving a better price by having their orders crossed by a market participant off-market. The Trades with Price Improvement (**TWPI**) exception balances the benefit to clients with the importance of price formation by requiring that these trades offer meaningful price improvement over the National Best Bid and Offer (**NBBO**) prices.
16. In 2022, ASIC conducted a thematic review of TWPI and observed a large number of trades executed by Instinet and reported as TWPI that did not provide price improvement over the NBBO.
17. ASIC informed Instinet of this issue on 14 September 2022.
18. On 12 October 2022, Instinet notified ASIC of a reportable situation that the BLX crossing system was incorrectly referencing the ASX best bid and offer, rather than the NBBO and that the BLX crossing system had been suspended prior to the market opening on 12 October 2022.
19. Between at least 1 January 2021 and 11 October 2022 the BLX crossing system was incorrectly referencing the ASX best bid and offer, rather than the NBBO. During this period, 3,093 trades reported as TWPI, did not provide price improvement over the NBBO within a 1 second window leading up to the times the trades were reported. The total value of these trades was \$13.48 million.

20. On 11 January 2023, in response to an ASIC notice, Instinet advised that:

‘The root cause of the crossing system incorrectly using the ASX best bid and offer quotes (“ASX BBO”), rather than the NBBO was revealed to have been due to an error in design and production of the system. IAPL’s Australian crossing system, BLX, was first released into production on 1 April 2011. At that time, the Chi-X market was not yet operational. When the Chi-X market was ultimately launched on 31 October 2011, it did not quote the same universe of securities as were quoted on the ASX market. There were therefore some securities for which there was only the ASX BBO to reference.

Whilst we cannot find documentation outlining the decision to reference the ASX BBO, it is possible that the staff responsible for developing the crossing system made this decision on the basis that the universe of securities covered by Chi-X was not complete. As this decision to reference the ASX BBO was not documented, IAPL was not aware that BLX was not referencing the NBBO (as was contemplated and documented in the original design and disclosure documents).’

21. The MDP considered that it had reasonable grounds to believe Instinet breached Rule 6.1.1 by matching orders off-market and away from the order book of a market, while incorrectly purporting to rely to the TWPI exception.
22. Instinet did not contest this contravention.
23. The MDP considered that this conduct should be treated as a single course of conduct from 1 January 2021 to 11 October 2022.

Third Alleged Contravention – Rule 7.4.2

24. Rule 7.4.2 provides:

(2) A Participant must provide Regulatory Data to a Market operator in a Trade Report made to that Market operator, for each side of the transaction for which the Participant acted as agent on behalf of a client, or as Principal.

25. Rule 7.4.4 defines Regulatory Data and includes, in relation to a Trade Report:

A code identifying the Market, Crossing System or other facility on which the orders were matched or the transaction was executed

26. Identification of the execution venue for transactions executed other than on an order book of a licensed market enhances the efficiency and effectiveness of ASIC’s surveillance function across execution venues and provides accurate data for ASIC and other market data users for analysing developments in market structure including off-order book liquidity (including liquidity in crossing systems).
27. Between 1 January 2021 and 31 January 2023, Instinet incorrectly reported the BLX crossing system as the execution venue for 940 transactions where the relevant transaction was not executed on the BLX crossing system.

28. The MDP considered that it had reasonable grounds to believe Instinet breached Rule 7.4.2 by incorrectly reporting these trades as having been matched on the BLX crossing system.
29. Instinet did not contest this contravention.
30. The MDP considered that this conduct should be treated as a single course of conduct from 1 January 2021 to 31 January 2023.

The determination of penalty

31. In determining the appropriate penalty for each alleged contravention, the MDP considered the four key factors set out in *ASIC Regulatory Guide 216: Markets Disciplinary Panel (RG 216)*, namely:
 - (a) the character of the conduct;
 - (b) the consequences of the conduct;
 - (c) the participant's compliance culture; and
 - (d) remedial steps taken by the participant.

Character of the conduct

32. While the MDP did not consider the conduct in respect of all three alleged contraventions to be reckless, it considered the conduct in respect of the first and second contraventions was more serious than careless and is best described as negligent. The MDP considered Instinet was negligent as it should have had procedures in place to prevent or detect possible non-compliance with the Rules applicable to crossing systems.
33. In respect of the first alleged contravention, the BLX Rulebook not only failed to disclose the extent to which indications of interests were used in the BLX crossing system, but inaccurately stated they were not used. While Instinet had reviewed and updated the BLX Rulebook since February 2014, it did not undertake a sufficiently thorough review or look at the document afresh to identify the error. The MDP considered the character of the conduct was an aggravating factor particularly having regard to the length of time over which it occurred.
34. In respect of the second alleged contravention, Instinet failed to update its BLX crossing system to reference the NBBO when Cboe (formerly Chi-X) became operational in October 2011 and started quoting the same securities as ASX. Instinet failed to detect this error for 11 years until it was detected by ASIC. Instinet failed to update its systems in line with market changes and in doing so failed to act in its clients' interests. As a licensed market participant, Instinet should have had systems and controls in place regarding the configuration and periodic review of critical trading technology systems and to ensure their ongoing integrity and compliance with the Rules. The MDP considered the character of the conduct was an aggravating factor.

35. In respect of the third contravention, while the MDP considered this was less serious than the second alleged contravention, the error occurred over at least a year and involved a large number of transactions. The MDP considered Instinet's conduct was careless.

Consequences of the conduct

36. The first alleged contravention occurred for a period of just over 8½ years, an extended period for the error to have gone undetected and for Instinet to have provided incorrect information about the use of indications of interest in the BLX crossing system. However the MDP noted that the ability to submit indications of interest offered by Instinet were not likely to be materially detrimental to clients, particularly given the limited nature of the indications of interest enabled by the BLX crossing system and given these indications were not visible to a wider audience. Nevertheless, the MDP were concerned about the importance to ensure clients are fully informed about the operation of crossing systems before they elect to use them. The MDP considered this factor as neutral.
37. In relation to the second alleged contravention, many clients were likely affected. While the total number of trades reported as TWPI that did not provide price improvement over the NBBO was over 3,000 with a value of over \$13.4 million, the loss to any client or to the clients overall was negligible. Nonetheless, the MDP considered that there was the potential for clients to be prejudiced and for the error to result in a loss of market confidence. The MDP considered this factor as neutral.
38. In relation to the third alleged contravention, the MDP considered this was less serious. While it is important for trading venue information to be accurately reported to assist ASIC in its surveillance functions, it did not impact clients. Further, the incorrect reporting was limited to trade venue and there was no misreporting regarding price or time of the trades. The MDP considered this factor as neutral.

Compliance culture

39. The MDP considered that the circumstances surrounding the alleged contraventions indicated concerns regarding Instinet's compliance culture.
40. While the alleged contraventions only relate to Instinet's BLX crossing system, the length of time the contraventions occurred showed that Instinet readily accepted a system that was designed over 10 years ago without conducting an in-depth review of the system's conformance with market rules. It did not update the system to account for market changes which suggests a poor market awareness and a 'set and forget' approach. It suggests Instinet did not have robust systems and controls to review its systems and identify these errors and may indicate broader failures in training, compliance monitoring and culture. The MDP considered this was an aggravating factor.

Remedial steps

41. Instinet's remedial step was to suspend the BLX crossing system. However, even after being contacted by ASIC regarding the failure to comply with the TWPI exception,

Instinet took one month to suspend the BLX crossing system during which time further trades took place in contravention of the Rules. This showed a lack of urgency to rectify the error by Instinet and disregard for trades in contravention of the Rules. The MDP considered this was an aggravating factor.

Penalty

42. A new penalty regime was imposed by the *Treasury Laws Amendment (Strengthening Corporate and Financial Sector Penalties) Act 2019*, which significantly increased the maximum penalties that can be specified in an infringement notice for each alleged contravention of a rule in relation to conduct that occurs wholly on or after 13 March 2019.

First Alleged Contravention – Rule 4A.3.2 and Rule 5A.2.2

43. In respect of the first alleged contravention, the conduct occurred between 10 February 2014 and 11 October 2022, which spanned across both the old and new penalty regime.
44. The maximum penalty for a single contravention for a breach of Rule 4A.3.2 of the Competition Rules and Rule 5A.2.2 of the Rules for conduct prior to 13 March 2019 is \$60,000. The maximum penalty for a single contravention of Rule 5A.2.2 of the Rules for conduct on or after 13 March 2019 is 15,000 penalty units (the amount of one penalty unit for conduct from 13 March 2019 to 30 June 2020 is \$210 and for conduct from 1 July 2020 to 31 December 2022 is \$222).
45. The MDP considered that the conduct should be treated as a single course of conduct and decided to apply a penalty based on the earlier penalty regime. Having regard to the length of time of the alleged contravention, the failure by Instinet to identify and rectify the error and the application of the old penalty regime, the MDP considered this serious and decided to impose a penalty of \$60,000 (being the maximum penalty for a single contravention under the old penalty regime). The entire amount of the penalty was applied to the first contravention, with no penalty being specified for each subsequent contravention.

Second Alleged Contravention – Rule 6.1.1

46. The MDP considered the second alleged contravention should be treated as a single course of conduct between 1 January 2021 and 11 October 2022. As the conduct occurred wholly after 13 March 2019, the new penalty regime applies.
47. The maximum penalty for a single contravention that occurs wholly on or after 13 March 2019 is 15,000 penalty units. The low range is up to 5,000 penalty units. The amount of one penalty unit for conduct between 1 July 2020 and 31 December 2022 is \$222.
48. Having regard to the circumstances of the second alleged contravention, the MDP considered the contravention to be in the middle of the low range and decided to impose a penalty of 2,000 penalty units (\$444,000). The entire amount of the penalty was applied to the first contravention, with no penalty being specified for each subsequent contravention.

Third Alleged Contravention – Rule 7.4.2

49. The MDP considered the third alleged contravention should be treated as a single course of conduct between 1 January 2021 and 31 January 2023. While some of this conduct occurred after 31 December 2022, when the penalty units increased from \$222 to \$275, the MDP decided to only impose a penalty based on a penalty unit of \$222.
50. Having regard to the circumstances of the third alleged contravention, the MDP considered the contravention to be in the low of the low range and decided to impose a penalty of 750 penalty units (\$166,500). The entire amount of the penalty was applied to the first contravention, with no penalty being specified for each subsequent contravention.
51. This makes the total penalty for the three alleged contraventions **\$670,500**.

Other information

The maximum pecuniary penalty payable under an infringement notice in relation to an alleged contravention of subsection 798H(1) of the Act, by reason of contravening Rule 4A.3.2 of the Competition Rules and Rule 5A.2.2 of the Rules for conduct that was not wholly after 13 March 2019 is \$60,000. The maximum pecuniary penalty payable under an infringement notice in relation to an alleged contravention of subsection 798H(1) of the Act, by reason of contravening Rule 5A.2.2 of the Rules for conduct on or after 13 March 2019 is \$3,150,000 for each contravention occurring between 19 March 2019 and 30 June 2020 and \$3,330,000 for each contravention occurring between 1 July 2020 and 31 December 2022.

The maximum pecuniary penalty payable under an infringement notice in relation to an alleged contravention of subsection 798H(1) of the Act, by reason of contravening Rules 6.1.1 and 7.4.2 is \$3,330,000 for each contravention occurring between 1 July 2020 and 31 December 2022 and \$4,125,000 for each contravention between 1 January 2023 and 30 June 2023.

Note: The maximum pecuniary penalty is 15,000 penalty units for a body corporate: see subsection 798K(2) of the Act. The amount of a penalty unit was \$210 between 13 March 2019 and 30 June 2020, \$222 between 1 July 2020 and 31 December 2022 and \$275 between 1 January 2023 and 30 June 2023: see subsection 4AA(1) of the Crimes Act 1914.

The maximum pecuniary penalty that a Court could order Instinet to pay for contravening subsection 798H(1) of the Act, by reason of contravening Rule 4A.3.2 of the Competition Rules and Rule 5A.2.2 of the Rules for conduct that was not wholly after 13 March 2019, is \$100,000.

The maximum pecuniary penalty that a Court could order Instinet to pay for contravening subsection 798H(1) of the Act (a civil penalty provision), by reason of contravening Rule 5A.2.2 (for conduct wholly on or after 13 March 2019), Rule 6.1.1 and Rule 7.4.2 of the Rules, is determined by section 1317G of the Act.

Note: Under subsections 1317G(2) and (4), the maximum pecuniary penalty per contravention is the greatest of:

- (a) 50,000 penalty units; and
- (b) if the Court can determine the benefit derived and detriment avoided because of the contravention—that amount multiplied by 3; and
- (c) either:
 - (i) 10% of the annual turnover of the body corporate for the 12-month period ending at the end of the month in which the body corporate contravened, or began to contravene, the civil penalty provision; or
 - (ii) if the amount worked out under subparagraph (i) is greater than an amount equal to 2.5 million penalty units—2.5 million penalty units.

To comply with this infringement notice, Instinet must pay the penalty within the compliance period. The compliance period starts on the day on which this notice is given to Instinet and ends 27 days after the day on which it is given. This penalty can be paid using the method detailed in the email by which this notice is given.

The effects of compliance with this infringement notice are:

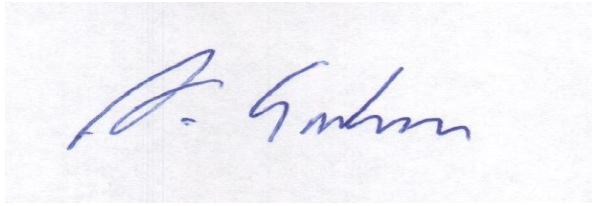
- (a) any liability of Instinet to the Commonwealth for the alleged contraventions of subsection 798H(1) of the Act is discharged; and
- (b) no civil or criminal proceedings may be brought or continued by the Commonwealth against Instinet for the conduct specified in the infringement notice as being 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 sections 914A, 915B, 915C or 920A of the Act against Instinet 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) Instinet is not taken to have admitted guilt or liability in relation to the alleged contraventions; and
- (e) Instinet is not taken to have contravened subsection 798H(1) of the Act.

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

Instinet 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.

The unique code for this notice is MDP 0616/23.

**Anthony Graham**

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.