ASIC
Australian Securities & Investments Commission

MDP
Markets Disciplinary Panel

PART 7.2A OF THE CORPORATIONS REGULATIONS 2001
INFRINGEMENT NOTICE

To: Macquarie Securities (Australia) Limited ACN 002 832 126
Level 6
50 Martin Place
SYDNEY NSW 2000

Matter: MDP 805/16
Date given: 19 April 2017

TAKE NOTICE: The Australian Securities and Investments Commission ("ASIC") gives this infringement notice to Macquarie Securities (Australia) Limited ("Macquarie") under regulation 7.2A.04 of the Corporations Regulations 2001 ("the Regulations").

To comply with this notice, Macquarie must pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **$505,000**.

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 (Chi-X Australia Market) 2011 ("the Rules") as in force at the time of the conduct.

Details of the alleged contraventions

1. Macquarie was a Market Participant in the Market operated by Chi-X Australia at all relevant times and was required by subsection 798H(1) of the *Corporations Act 2001* ("the Act") to comply with the Rules.

2. Rule 5.5.2 of the Rules provided:

   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; …

3. Rule 5.6.1(1) of the Rules provided:

   A Market Participant which uses its system for Automated Order Processing must at all times:

   (a) have appropriate automated filters, in relation to Automated Order Processing; and

   (b) ensure that such use does not interfere with:

      (i) the efficiency and integrity of the Chi-X Market;

4. Rule 5.7.1(b)(iii) of the Rules provided:

> A Market Participant must not make a Bid or Offer for, or deal in, any Equity Market Products:
>
> (a) …
>
> (b) on account of any other person where: …
>
> (iii) taking into account the circumstances of the Order, a Market Participant ought reasonably suspect that the person has placed the Order with the intention of creating,
>
> a false or misleading appearance of active trading in any Equity Market Product or with respect to the market for, or the price of, any Equity Market Product.

5. Rule 5.7.2 of the Rules sets out certain matters that a Market Participant must have regard to in considering the circumstances of the Order, including:

   (a) whether the Order would be inconsistent with the history of or recent trading in that Equity Market Product;

   (b) the time the Order is entered;

   (c) the frequency with which Orders are placed by a person;

   (d) the extent to which a person amends or cancels an instruction to purchase or sell an Equity Market Product relative to the number of Market Transactions executed for that person;

   (e) the frequency with which Orders are placed by a person;

   (f) where the Order appears to be part of a series of Orders, whether when put together with other Orders which appear to make up the series, the Order or the series is unusual having regard to the matters referred to in Rule 5.7.2.

On-boarding process of the new client

6. The MDP was satisfied that:

   (a) in July 2014, Macquarie on-boarded a new client (the "new client"). The new client was of a kind that was a departure from Macquarie's traditional client base. Macquarie was aware that the new client would be acting for another foreign body corporate (the "underlying client"), a proprietary trading firm which specialised in intraday trading, and that the new client and underlying client were directly or indirectly owned and controlled by the same individual. Macquarie was told by the new client that up to 700 traders (the "traders") employed by the underlying client would be trading on the account and that those traders were acting independently of each other;

(b) Macquarie was aware that the underlying client had been previously fined for market manipulation by an overseas regulator, but was told by the new client that the incident was isolated and that action had been taken by the underlying client to terminate the traders who engaged in the conduct;

(c) in August 2014, Macquarie set up a Direct Market Access ("DMA") account for the new client to enable it to use Macquarie's Automated Order Processing ("AOP") system to enter Orders into both the Chi-X Market and the ASX Market; and

(d) between August and September 2014, Macquarie customised the parameters of the concurrent Bid / Offer filter that applied to its AOP system at the request of the new client to accommodate the client's assertion that its underlying client had multiple traders.

Trading behaviour of the new client during the Initial Period

7. The MDP was satisfied that:

(a) between 20 August 2014 and 13 October 2014 (the "Initial Period") the new client entered Orders into the Chi-X Market via the AOP system in relation to more than 1,000 different classes of securities of which 939 classes were outside the ASX100 and 854 classes were outside the ASX200;

(b) the entry of these Orders on the Chi-X Market generated approximately 42,000 alerts from Macquarie's post-trade surveillance software alert system ("SMARTS") of which 98.9% warned of potential market manipulation and, in relation to Orders in relation to shares of Panorama Synergy Limited ("PSY"), generated 289 SMARTS alerts which warned of potential market manipulation;

(c) the Orders entered by the new client in relation to shares in PSY were indicative of a pattern of behaviour, namely:

(i) the Bids entered by the new client made up a significant proportion of the Bid schedule for PSY and more than 70% of those Bids were not traded and were subsequently cancelled, a pattern which was inconsistent with the new client's Offers, and the Orders of the rest of the market; and

(ii) throughout the last 2 weeks of the Initial Period:

(A) a significant number of Bids were entered by the new client soon after the opening of the Chi-X Market so as to establish a position in the Bid schedule;

(B) for each Trading Day, the Bids entered by the new client made up at least 80% of the Bid schedule;

(C) the new client entered a significant proportion of Bids at prices that were above the rolling average daily movement from the opening price to the lowest price of the day for the previous 250 Trading Days but, in contrast, the new client's Offers tended to be entered at or below this rolling average;

(D) the new client consistently entered and cancelled Bids throughout each Trading Day, which generally maintained its position in the Bid schedule for the Trading Day;

(E) towards the end of each Trading Day, the new client cancelled the remainder of the Bids sitting in the Bid schedule;

(d) the asserted underlying traders were not ending each trading day with a net zero position but, on a cumulative basis, the new client was ending most Trading Days with a net zero position, a result which was not reasonably explicable unless there was a scheme of co-ordination;

(e) within a matter of days of the new client commencing trading through Macquarie's AOP system, Macquarie's Compliance area suspected the underlying client was using a trading engine based on the large number of Orders being entered and deleted in the course of seconds; and

(f) Macquarie however did not undertake a review of the new client's trading during the Initial Period that was sufficiently detailed to identify that the vast majority of positions held by the underlying traders at the end of each Trading Day were offset against each other such that the new client was reaching a net zero position at the end of nearly every Trading Day.

Trading behaviour of the new client during the Relevant Period

8. The MDP was satisfied that between 14 October 2014 and 17 October 2014 (the "Relevant Period") the new client's pattern of trading behaviour on the Chi-X Market in relation to trading in PSY was materially the same as the new client's pattern of trading behaviour on the Chi-X Market in relation to trading in PSY during the Initial Period.

Senior management made aware of possible market manipulation

9. The MDP was satisfied that:

(a) on 13 October 2014, Macquarie's Trade Surveillance Monitoring area sent an internal memo (the "13 October 2014 memo") to Macquarie's senior management, which highlighted the significant number of SMARTs alerts in relation to the trading by the new client on the Chi-X Market and advised that "[t]here is very strong evidence Macquarie is being used for a tried and tested model of market manipulation, namely layering … [and] a temporary suspension of client activity may be appropriate until a thorough evaluation of the fitness and appropriateness of these clients is undertaken";

(b) on 23 October 2014, a meeting occurred between Macquarie's senior management and Macquarie's Trade Surveillance Monitoring area where the new client's trading was considered, and it was agreed that a Suspicious Activity Report ("SAR") would be drafted;

(c) on or about 30 October 2014, the draft SAR was considered by Macquarie's senior management who decided that, based on the information in the draft SAR, it was insufficient to found a suspicion of the kind which would require a SAR to be lodged with ASIC;

(d) between 30 October and 14 November 2014, internal communications continued between Macquarie's Trade Surveillance Monitoring area and Macquarie's senior management in relation to the new client's trading, however the draft SAR was never finalised or lodged with ASIC;

(e) on 21 November 2014, Macquarie terminated the new client's account. This was the same day that ASIC indicated to Macquarie that if ASIC's further analysis revealed evidence of market manipulation, ASIC was prepared to consider using its compulsory powers to direct Macquarie to cease providing the new client with access to Macquarie's AOP system.

Rule 5.7.1(b)(iii) (suspicion of market manipulation)

10. The MDP has reasonable grounds to believe that, by 14 October 2014 in relation to the submitting of Orders by the new client in relation to PSY on the Chi-X Market, Macquarie contravened Rule 5.7.1(b)(iii) and, as a result, contravened subsection 798H(1) of the Act.

11. The MDP accepts that Macquarie may not have known at the relevant time that, because the positions held by the underlying traders at the end of each Trading Day were offset against each other, the new client was reaching a net zero position at the end of most Trading Days. Macquarie did not know this information at the relevant time because it did not undertake a review that was sufficiently detailed to identify it. But Macquarie's Compliance area suspected from the very outset that the new client was using a trading engine.

12. Having regard to the trading behaviour of the new client during the Initial Period and following the 13 October 2014 memo, a Market Participant, in the position of Macquarie at the relevant time, ought to have reasonably suspected the new client was submitting the Orders in relation to PSY with the intention of creating a false or misleading appearance with respect to the market for, or the price of, PSY.

13. Macquarie's conduct was reckless. Macquarie did not terminate the client's account until 21 November 2014 after ASIC had indicated its likely course of action. This was 39 days after a Market Participant in the same position as Macquarie at the relevant time ought reasonably have suspected the new client was placing Orders in relation to PSY with the intention of manipulating the market for PSY. At no time throughout that 39 day period did Macquarie suspend the new client's account pending further enquiry.

14. Macquarie employees foresaw the possible harmful consequence to the integrity of the market arising from the conduct of the new client – both during the Initial Period and the Relevant Period – but nevertheless Macquarie's management permitted the client to continue its trading behaviour, through Macquarie's AOP system, for a period of time with a degree of indifference or disregard to the market consequences.

15. The penalty payable for the alleged contravention of Rule 5.7.1(b)(iii) is $225,000 This amount falls in the middle range of penalties for an alleged contravention of that Rule (see Table 5 of ASIC Regulatory Guide 216).

Rule 5.6.1 (appropriate AOP filters)

16. The determination of the appropriate parameters of AOP filters for a particular client or particular class of clients will depend on, among other things, the type and volume of Orders submitted through the AOP system, having regard to the risk to the efficiency and integrity of the Market.

17. A Market Participant needs to know their client. The Market Participant is best placed to assess and manage the risk of interference to the efficiency and integrity of the Market as a result of their client's use of their AOP system.

18. Macquarie's default concurrent Bid / Offer filter parameter for a client was a maximum number of 5 per security, per side. To accommodate the new client's particular business model, Macquarie progressively customised the filter parameters:

    (a) between about 19 August and 25 September 2014, the filter parameters were set at 350 concurrent Orders per security, per side. The filter was set at the new client "parent" level and not at the underlying trader level;

    (b) from 19 August 2014, the new client began providing Macquarie with an identifying code for each trader so as to enable Macquarie to develop a filter at the underlying trader level rather than at the new client "parent" level;

    (c) from about 26 September 2014, the filter permitted 10 concurrent Orders per side, per security, per underlying trader; and

    (d) from about 30 September 2014, the filter permitted 5 concurrent Orders per side, per security, per underlying trader.

19. During the Relevant Period, the concurrent Bid / Offer filter parameters specified in paragraph 18(d) was used in relation to the new client in circumstances where Macquarie believed that up to 700 underlying traders could be trading through the new client. This change to the filter parameter allowed the new client to submit 3,500 Orders per side, per security. The filter did not distinguish between the relevant liquidity of the securities. By customising the filter to accommodate the new client's business model, the potential to impact the market for illiquid securities was significantly heightened. PSY was a relatively illiquid security.

20. Macquarie was aware of the new client's pattern of trading behaviour in relation to trading in PSY during the Initial Period but rather than adopt measures to minimise the risk of, and opportunity for, market manipulation by the new client, Macquarie actions had created a more fertile environment for market manipulation to occur. There is no suggestion that Macquarie encouraged or intended for the new client to engage in market manipulation.

21. The conduct of Macquarie was not indicative of a systemic failure in relation to its automated AOP filters. The business model of the new client was unique among Macquarie's clients, and the changes that Macquarie made to the concurrent Bid / Offer filter were designed to accommodate this client's particular business model.

22. The penalty payable for the alleged contravention of Rule 5.6.1 is $80,000. This amount falls in the lower range of penalties for an alleged contravention of that Rule (see Table 4 of ASIC Regulatory Guide 216). This is not a reflection that the MDP viewed this conduct as less serious. The MDP considered that the issue of appropriate AOP filters was a key part of the conduct in relation to the alleged contravention of Rule 5.5.2 (organisational and technical resources). To that extent, the penalty in relation to the issue of appropriate AOP filters is reflected in both the penalty payable for the alleged contravention of Rules 5.6.1 and 5.5.2.

Rule 5.5.2 (organisational and technical resources)

23. The MDP has reasonable grounds to believe that, between 20 August 2014 and 24 October 2014 in relation to the submitting of Orders by the new client on the Chi-X Market, Macquarie contravened Rule 5.5.2 and, as a result, contravened subsection 798H(1) of the Act.

24. Macquarie had organisational and technical resources in place, much of it sound. It had a SMARTS surveillance system and Trade Surveillance Monitoring area who were responsible for monitoring SMARTS alerts. It had a Market Surveillance Programme which provided material relating to its surveillance systems, and other guidance on how to escalate trading issues appropriately.

25. The key organisational failure was the inexplicable delay of Macquarie's management in completing the SAR and further failing to suspend the new client's account until it was satisfied that it was meeting its obligations under the Rules. The delay was inexplicable, particularly in light of the unprecedented increase in SMARTS alerts identifying potential market manipulation by the new client in circumstances where Macquarie had recognised in its account opening processes that the new client represented a material change to its risk profile as a Market Participant.

26. Coupled with the above were the shortcomings in technical resources and capability in its Trade Surveillance Monitoring processes. In August 2014, Macquarie's Trade Surveillance Monitoring area, which had only recently taken over responsibility for monitoring SMARTS alerts, had concerns about its ability to effectively assess SMARTS alerts. These concerns related to multiple systems within Macquarie which lacked the functionality to produce reports in order to conduct a proper analysis of all Orders of a client that were generating alerts.

While these concerns were not in relation to the particular trading of the new client, they indicate that the very area designated to monitor SMARTS alerts thought that the system deficiencies were potentially problematic.

27. When the parameters of the concurrent Bid / Offer filter were changed so that it applied at the underlying trader level and not at the new client "parent" level, there was no corresponding change to the application of the SMARTS alerts which continued to apply at the new client "parent" level. This resulted in the unprecedented volume of SMARTS alerts.

28. Macquarie proceeded on an assumption that the most likely explanation for the unprecedented volume of SMARTS alerts was solely because of the unique trading strategy employed by the underlying traders who traded through the client. Macquarie's approach was to proceed on an assumption that gave the benefit of the doubt to the new client while Macquarie was assessing the situation with a view to testing the veracity of that assumption. But the reasonableness of that assumption became increasingly untenable over time.

29. The MDP accepts that Macquarie was not ignoring the concerns about the new client's trading behaviour. The MDP accepts that it was appropriate for Macquarie to complete a thorough analysis. However, the MDP does not accept that it was appropriate for Macquarie to have allowed the client to continue to trade through the AOP system while Macquarie was assessing the situation. Macquarie could have temporarily suspended the new client's account while it completed a thorough analysis, but it did not do so.

30. The efficiency and integrity of the Chi-X Market did not seem to be the paramount consideration that was guiding Macquarie in its decision-making in relation to this new client. Macquarie gave the new client the benefit of the doubt, at the risk of interfering with the efficiency and integrity of the Chi-X Market, in circumstances where it was not reasonable to have given the client the benefit of the doubt. That approach was reckless.

31. The penalty payable for the alleged contravention of Rule 5.5.2 is $200,000. This amount falls in the middle range of penalties for an alleged contravention of that Rule (see Table 5 of ASIC Regulatory Guide 216).

Other information

The maximum pecuniary penalty that a Court could order Macquarie to pay for contravening subsection 798H(1) of the Act by reason of contravening Rules 5.5.2, 5.6.1 and 5.7.1(b)(iii) is $1,000,000 in relation to each rule.

The maximum pecuniary penalty payable by Macquarie under an infringement notice in relation to the alleged contravention of Rules 5.5.2, 5.6.1 and 5.7.1(b)(iii) is $600,000 in relation to each rule.

Compliance with the infringement notice

To comply with this infringement notice, Macquarie must pay the penalty within the compliance period. The compliance period starts on the day on which this notice is given to Macquarie 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 Macquarie 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 Macquarie for the conduct specified in the infringement notice as being the conduct that made up the alleged contravention 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 Macquarie for the conduct specified in the infringement notice as being the conduct that made up the alleged contravention of subsection 798H(1) of the Act; and

(d) Macquarie is not taken to have admitted guilt or liability in relation to the alleged contravention; and

(e) Macquarie is not taken to have contravened subsection 798H(1) of the Act.

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

Macquarie may apply to ASIC for withdrawal of this 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

Grant Moodie
Special Counsel to the Markets Disciplinary Panel
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.