ASX

Notice

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Disciplinary Matter – BBY Limited

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Disciplinary Matter

The Chief Compliance Officer ("CCO") of ASX Compliance Pty Limited ("ASX") has determined that BBY Limited ("BBY") did not comply with ASX Clear Operating Rules:

- 4.1.1(a) in that it failed to continue to satisfy the Admission Requirements of ASX Clear Operating Rule 3.2.1(f) by reason of the fact that on 12 and 16 June 2014 BBY could not satisfy ASX Clear that it had financial resources which were adequate for the performance by BBY of its obligations as a Participant under the ASX Clear Operating Rules, in particular its obligation to meet margin calls under ASX Clear Operating Rule 14.6.1.
  ("Contravention 1")
- 4.8.1 in that BBY did not have an appropriate management structure in place, including operations and processes:
  (a) to ensure that its Responsible Executives have adequate supervision and effective control over all parts of the Participant's business relating to the Participant's activities in ASX Clear, wherever the conduct occurs or the business is located and regardless of the number of offices operated or intended to be operated by the Participant;

  (b) which are reasonably designed, implemented and function so as to achieve compliance by the Participant with the ASX Clear Operating Rules;

  by reason of the fact that on 12 and 16 June 2014 BBY was not able to manage and achieve compliance with its obligations to pay margin calls under ASX Clear Operating Rule 14.6.1.

  ("Contravention 2")
- 4.23.2 in that on 11 June 2014 BBY did not deposit $29 million from its client, which was money to which Division 2 of Part 7.8 of the Corporations Act 2001 applied, into its trust account.
  ("Contravention 3")

(collectively Contravention 1, Contravention 2 and Contravention 3 are referred to as the "Contraventions").

BBY did not contest the Contraventions.

The CCO imposed a fine of $180,000 (plus GST) (consisting of a combined fine of $150,000 (plus GST) for Contraventions 1 and 2, and a fine of $30,000 (plus GST) for Contravention 3).

The CCO also directed that BBY is to implement a remediation plan, acceptable to ASX, to address the recommendations made by independent experts to improve BBY's risk management systems and internal processes.

<u>The circumstances of this matter are as follows:</u>

On Wednesday 11 June 2014, BBY executed an acquisition of 51,396,620 shares in Aquila Resources Limited ("AQA") at an average price of $3.74 per share for its client (the "AQA Transaction"). At this time AQA was the subject of a joint takeover bid by Baosteel Resources Australia Pty Ltd and Arizon Operations Limited (together the "Bidders").

The AQA Transaction was valued at approximately $192 million and BBY had this position registered in its name as the clearing participant.

By the close of trading on Wednesday 11 June 2014 the price of AQA had fallen to $3.61, resulting in a loss in the mark to market value of BBY's position in AQA of approximately $7 million as a result of the AQA Transaction.

On Thursday 12 June 2014, as a consequence of the AQA Transaction and its other open positions, BBY was due to be called approximately $40 million of margins by ASX Clear, consisting of approximately $18 million of Initial Margin, $7 million of Variation Margin and a $15 million Capital Based Position Limit ("CBPL") additional margin payment.

On Thursday 12 June 2014 at approximately 8.35am BBY advised ASX that it had not taken into account that the AQA Transaction would incur a CBPL additional call of $15 million. BBY had put in place a funding line for $30 million so it could settle the Cash Market Margin of $25 million but it would not be able to settle the CBPL call as BBY only had an available balance of $5 million left under the funding facility. BBY requested that ASX not call BBY for the additional CBPL margin.

ASX advised BBY that to prevent it from committing an event of default and suffering a possible insolvency event, ASX would delay making the full CBPL call of $15 million but would be making an additional CBPL call for $5 million – the full balance of funds available to BBY at that time. ASX Clear also imposed a number of conditions on BBY's admission limiting its ability to enter into transactions that would have increased its margin exposure and requested BBY to take all steps to pursue early settlement of the transaction and exhaust all avenues to access greater liquidity to meet potential Variation Margin and the actual CBPL.

The CBPL additional call for $5 million was settled by BBY at approximately 11.12am on 12 June 2014.

On Friday 13 June 2014, at approximately 10.30am, BBY confirmed with ASX that $10 million shareholder funds had been received into BBY's bank account and at approximately 11.35am BBY settled the outstanding CBPL additional call for $10 million, and a further $3.2 million Variation Margin call following a further decline in the AQA share price the previous day.

On Friday 13 June 2014 BBY advised the ASX that the full $192 million was in BBY's bank account and available for settlement.

At approximately 3pm on Friday 13 June 2014 AQA released an announcement advising that the Bidders would not increase the takeover offer price of $3.40 cash per share for AQA resulting in its share price declining approximately 48 cents.

At this point ASX advised BBY that the decline in AQA share price would result in an estimated $22 million Variation Margin call on Monday 16 June 2014. BBY confirmed it had exhausted all of its funding lines and would not be able to pay the $22 million Variation Margin call on Monday morning. BBY requested if ASX could delay making the Variation Margin call on Monday 16 June 2014.

ASX agreed to delay calling the $22 million Variation Margin on Monday 16 June 2014 on the basis that:

- ASX had received confirmation from BBY's bank that the $192 million for the purchase of the AQA Transaction had been received from its client; and
- the delay would prevent BBY from committing an event of default and a possible insolvency event.

On Monday 16 June 2014 the selling party had failed to deliver stock which prevented settlement of the AQA Transaction. As a consequence, ASX advised BBY that no margins in relation to the AQA transaction would be returned to BBY until the selling party had delivered stock and the full position had been settled.

On Tuesday 17 June 2014 at approximately 3.03pm the outstanding purchase under the AQA Transaction settled and the related margins were returned to BBY.

Following ASX investigations around the circumstances of the AQA Transaction it was revealed that on 11 June 2014 BBY had requested and received a security deposit of $29 million from its client (the "Security Deposit").

The Security Deposit appears to have been deposited and held in BBY's general ledger account and at no point was deposited into a BBY trust account.

On Thursday 19 June 2014 ASX Limited and ASX Clear imposed a number of conditions on BBY's participation in ASX and ASX Clear intended to prevent a recurrence of this event. The letter imposing these conditions noting that they would remain in place until BBY provided ASX with a report from a third party, satisfactory to ASX Clear, expressing an opinion (and the reason for that opinion) on the adequacies of BBY's risk management systems and processes to prevent a recurrence of events similar to those caused by the AQA Transaction and a capital management liquidity plan, satisfactory to ASX Clear, indicating that it has the financial resources to support these types of transactions.

In accordance with these conditions, BBY has engaged independent experts to advise on the adequacies of BBY's risk management systems and processes. The chosen experts have provided reports to BBY with a number of recommendations to improve BBY's risk management systems and processes.

In determining the penalty referred to above, the CCO, among other things, took into account the following matters:

(a) The Contraventions were an isolated event arising as a result of the AQA Transaction, although their impact spread over five business days from the time the AQA Transaction occurred on Wednesday 11 June 2014 until the time it completely settled on Tuesday 17 June 2014.

(b) BBY communicated openly and co-operated fully with ASX in managing the potential default in payment of CBPL and Variation Margin and in ASX's investigations into the matter afterwards.

(c) The efforts BBY undertook to reduce the potential exposure of the clearing house to a default on the AQA transaction, including obtaining an additional $10 million in shareholder funds to meet its CBPL margin call within 24 hours.

(d) BBY obtained the full settlement amount from the client on Friday 13 June 2014 which was available for settlement on T + 2.

(e) BBY at its expense has engaged independent experts to review the adequacy of its risk management framework and internal processes.

(f) ASX has required BBY to implement a remediation plan, acceptable to ASX, to address the recommendations made by the independent experts.

(g) The CCO formed the view that these are serious contraventions. Had ASX required BBY to meet its margin obligations in full in accordance with the ASX Clear Operating Rules, on its own admission, BBY would not have been able to meet its debts as they fell due.

(h) The CCO is of the view that Contraventions 1 and 2 demonstrate recklessness by BBY in entering into a transaction as significant as the AQA Transaction without having appropriate systems and processes in place to calculate, manage and fund its margin obligations.

(i) The Contraventions appear to have occurred because of weaknesses in BBY's risk management and compliance framework (specifically, in the case of contraventions 1 and 2, in terms of its management oversight and decision making with respect to the AQA Transaction and its systems and processes to calculate, manage and fund its margin obligations, and in the case of contravention 3, its processes for handling client money).

(j) BBY received a financial benefit because of Contraventions 1 and 2 in that it received commission on a transaction that it should not have undertaken in the circumstances. It also received a financial benefit as a result of ASX not making or delaying margin payments to prevent a potential insolvency event for BBY, which could have had a serious impact on the market, the clearing and settlement facilities, BBY and BBY's clients and employees.

(k) BBY's disciplinary history.

(l) The totality principle.

Sanction Guidelines

As the contravening conduct occurred after 1 August 2010, that being the effective time under the ASX Enforcement and Appeals Rulebook, the CCO was bound by the sanction guidelines (Annexure A to the Rulebook) in making his determination as to appropriate sanction in this matter.

The CCO determined that given the circumstances in this matter a fine of $180,000 (plus GST) is an appropriate sanction.

The CCO is of the opinion that this sanction will act as a deterrent and appropriately serves the interests of ASX and its Participants.