

## ASX Disciplinary Matter – Bell Potter Securities Limited

ASX Limited's Chief Compliance Officer (“**CCO**”) has determined that Bell Potter Securities Limited (“**BPS**”) did not comply with:

- ASX Clear (Futures) Operating Rules (“**ASX CFR**”) 43 / 44, in that, on 31 October 2016, it failed to pay amounts owed by way of Initial Margin and / or Daily Settlement in relation to certain NZD bank bill contracts on time (“**Contravention 1**”);
- ASX 24 Operating Rule (“**ASX 24 OR**”) 1000(d) and ASX CFR 4.2(e), in that, on and around the time of Contravention 1, it did not have adequate resources and processes to comply with its obligations as a trading and clearing participant in relation to those NZD bank bill contracts (“**Contraventions 2 and 3**”);
- ASX 24 OR 3500, ASX CFR 4.61, and ASX CFR 4.2, and ASX 24 OR 1000(d), in that, between September and October 2016, it failed (due to software vendor issues) to submit daily beneficial ownership reports (“**DBORs**”) and to advise ASX of the number of Open Positions it wished to remain open on two separate occasions, and consequently it did not have sufficient resources and processes to perform these functions (“**Contravention 4**”);
- ASX 24 OR 6704, as it failed, due to a mapping error in its back office settlement system, on multiple occasions between July and September 2017, to ensure that the information it submitted in its DBORs was complete, accurate and not misleading (“**Contravention 5**”); and
- ASX 24 OR 1400(e) and its associated procedure, in that it failed to notify ASX around July 2017 that regulatory action was being taken or may be taken against it under the Corporations Act that related to its activities as a participant (“**Contravention 6**”).

Defined terms have the meaning provided in the ASX 24 OR and ASX CFR, unless provided.

The circumstances of this matter are as follows:

### *Contraventions 1, 2 and 3*

On 28 October 2016, BPS executed 200 NZD bank bill contracts for a client with the intention that the position be allocated to another ASX 24 participant for clearing. BPS allocated the trade in its Genium 'holding give-up' screen where the trade awaited confirmation. By the close-of-business on 28 October 2016, the trade was not confirmed and the contracts were designated to BPS's house account, in accordance with ASX 24 OR 3711 and 3713.

At around 7:00AM on 31 October 2016, ASX notified BPS of its initial margin and daily settlement obligations based on all open positions held by it. This obligation included a NZD 115,118.00 payment to ASX which was to be matched by 10:30AM and settled by 11:00AM. At 9:30AM, the payment amount was put into NZ Clear for BPS to match and settle.

At around 10:11AM, ASX contacted BPS by telephone to notify it of the NZD margin obligation remained unmatched and reminded them of the prescribed time for payment. At around 10:23AM, BPS emailed its participating bank instructing them to effect settlement. Staffing at the participating bank was limited due to a public holiday the following day in Melbourne. BPS was unable to immediately identify personnel to effect payment.

At around 11:49AM, ASX contacted BPS to enquire about the late margin. BPS confirmed they would investigate and respond shortly. BPS then advised that the delay was caused by its participating bank and that BPS were actively attempting to contact its relationship manager at ANZ to release the funds.

At approximately 12:00PM, the NZD margin obligation was matched and settled.

#### *Contravention 4*

On 25 September 2016, the vendor of BPS's back-office settlement system ("**BOSS**") identified a system issue affecting the BOSS as well as its clearing system. On 26 September 2016, BPS contacted ASX to advise that its BOSS was down. On 27 September 2016, BPS notified ASX that it would not be submitting its DBOR file for 26 September 2016 by 8am due to a software vendor issue. On 29 September 2016, BPS submitted its DBOR files for 26, 27 and 28 September 2016. BPS notified ASX on each day during the system issue that a DBOR would not be provided.

On 29 September 2016, BPS notified ASX that it had breached ASX 24 OR Procedure 3500.1(a) due to its vendor experiencing a significant failure in their data centre on 25 September 2016. The effect of this failure was that BPS's BOSS was unavailable.

On 30 September 2016, BPS returned to submitting DBOR files by the time required by ASX 24 OR 3500.

On 28 October 2016, BPS provided ASX with a copy of an incident report which included the following information:

- At around 05:45AM SGT on 26 September 2016, the vendor notified BPS that it would move production to its disaster-recovery location.
- The recovery environment did not have the application configuration files required to recover end-of-day processing and create client statements. Client configurations had to be restored manually, which significantly impacted recovery times.
- While the vendor conducted a formal disaster-recovery exercise in April 2016, it had not tested capacity to support the recovery of all clients simultaneously, which also contributed to the recovery times.

BPS later notified ASX that it had also been unable to perform net-downs during the outage.

#### *Contravention 5*

In July 2017, ASX was conducting a review of BPS's DBOR data during which it identified what appeared to be a 1 lot-break in an option position reported beginning 15 June 2017. BPS responded to ASX's enquiries confirming that:

- The misreported position was due to a strike price being entered in the incorrect format into its DBOR file for a new electricity options contract, and that this mistake was corrected in DBORs submitted from 11 July 2017.
- The error in the format of the strike price was due to the vendor incorrectly mapping ASX 24 contracts in the BOSS.
- On 12 July 2017, it had urgently engaged the vendor to perform testing and fixes of mapping issues which would be carried out in the week commencing 11 September 2017, and that it couldn't be done sooner because of insufficient resources.

On 19 July 2017, BPS self-reported a breach of ASX 24 OR 4840 in its DBOR file submitted for 18 July 2017. A trade was duplicated in BPS's BOSS due to manual input of the trade by back-office personnel. The error was identified in end-of-day reconciliation processes performed by BPS back-office personnel on 18 July 2017, but the matter was escalated on 19 July 2017.

On 6 September 2017, ASX identified that three options series had failed to be processed in the DBOR file submitted by BPS for 5 September 2017. The failure appeared to be due to incorrect strike prices being used in the DBOR file. The error was corrected in the DBOR submitted on 11 September 2017. BPS informed ASX that:

- The misreported positions were due to the same FIS mapping issue that affected the previous DBOR submission in June 2017.
- The position originated on 29 August 2017 and would have affected DBORs submitted between that date and 11 September 2017. ASX had not otherwise registered concern, notwithstanding that the character length of the strike price field in the DBOR file was incorrect.

On 11 October 2017, BPS confirmed to ASX that the test file was finalised and that the mapping issue should be resolved.

#### *Contravention 6*

On 20 July 2017, BPS was informed by the Australian Securities and Investments Commission (“ASIC”) that the ASIC Market Disciplinary Panel (the “MDP”) had found there to be reasonable grounds to believe that breaches by BPS of ASIC Market Integrity Rule (ASX Market 2010) (“MIR”) 5.7.1(a) and MIR 5.11.1 had occurred and that an infringement notice would be issued in due course.

On 17 August 2017, BPS notified ASX through a purported reliance on ASX OR 1400(e) that ASIC was investigating an alleged breach of MIR 5.7.1 (a) and MIR 5.11.1 by BPS. The notification did not refer to the fact that:

- the MDP had determined that it had reasonable grounds to believe that the breaches occurred; or
- the MDP intended to issue an infringement notice to BPS in relation to that determination,

which BPS subsequently confirmed.

#### In determining penalty, the CCO, among other things, took into account the following matters:

- (a) The ASX CFR and ASX 24 OR require an applicant for admission as a participant to have “adequate resources and processes” to comply with its obligations as a participant in ASX’s markets or facilities. These obligations continue during the term of a participant’s admission.

These obligations comprise, among other things, maintaining up-to-date and documented processes to comply with a participant’s primary obligations under the operating rules, as outlined under Section 3.5 (resources and processes) of both the ASX CFR and ASX 24 OR Guidance Note 1 (each “GN 1”). In addition to documenting the key processes, ASX expects participants to fully implement them by putting them into practice and integrate them into the day-to-day conduct of their business.

When consideration is had to the Contraventions taken as a whole, ASX is satisfied that BPS did not have an effective compliance program, risk management framework, and operational and technological processes. ASX must regard a failure of this degree as an aggravating factor with respect to each Contravention, warranting a penalty that will act as a sufficient deterrent.

- (b) In BPS’s favour, ASX notes that there is no evidence of BPS:
- deriving financial benefit or commercial advantage; or
  - acting unconscionably towards, or otherwise taking advantage of, clients or counterparties, in relation to the Contraventions.

#### *Contravention 1, 2 and 3*

- (c) ASX is a central clearing counterparty, and is thereby subject to the Reserve Bank of Australia’s Financial Stability Standards (the “FSS”). ASX therefore has obligations to cover its credit exposures to its participants for all products, and manage its exposure to potential losses arising from a participant default.

- (d) ASX has instituted a daily margin regime in the ASX 24 market to cover the potential exposure of closing out a portfolio of cleared trades in the event of a default by a participant. Consequently, if a participant fails to pay a daily margin to ASX by the prescribed time, ASX will regard this as a failure to meet a fundamental risk control.

- (e) ASX regards:
- ensuring that trades in the clearing system are allocated to another Trading Participant entitled to receive allocations pursuant to ASX 24 OR 3708 (as required by Section 3.5 of ASX 24 GN 1); and
  - meeting its initial margin and daily settlement amounts pursuant to ASX CFR 43 and 44 (as required by Section 3.5 of ASX CFR GN 1),

to be key processes for a participant to meet its obligations under the rules.

- (f) It cannot be said that BPS had “adequate resources and processes” where:
- BPS used a daily checklist which required the relevant officer to confirm that all trades had been given up by close of business. This was not followed in this case, as the defect was not noticed *and* the check was not performed until the following business day.
  - During ASX’s investigation, BPS stated that it does not clear NZD contracts, and noted that its participating bank acts as its agent for contracts cleared through Austraclear. ASX reminds participants that clearing obligations attach to contracts held, regardless of their denomination, particularly with respect to the margin obligations that arise if contracts are not given up before the end of day.
  - BPS’s responses regarding its own arrangements for the meeting of NZD margin obligations were confused.
  - BPS admitted that it was not aware of the margin obligation until it was contacted by ASX.
  - Prior to the event, BPS’s compliance program did not include any independent compliance monitoring activities relating to its margin obligations. In response to these events, BPS scheduled an independent audit.
- (g) For the ASX 24 margin regime to be sufficiently robust to meet the requirements of the FSS, a participant is responsible for the acts or omissions of their participating bank, and must have appropriate service-level agreements in place to mitigate the risk of failure to meet ASX CFR payment obligations.
- (h) BPS has committed one breach of an obligation to pay a margin amount since 2015.
- (i) In May 2017, ASX imposed a penalty of \$15,000 (plus GST) against a participant in relation to a delay of 15 minutes in settling a margin obligation of \$43,046.<sup>1</sup> ASX considers that the present matter warrants a higher penalty because of the higher margin amount, the longer the delay in settling the matter, and the organisational inadequacies explained above.

#### *Contravention 4*

- (j) ASX uses DBOR data to perform several monitoring activities, including:
- monitoring all ASX futures contracts at a client level throughout the life of the contract;
  - monitoring daily close-outs of matched positions as required under the ASX CRF;
  - monitoring the expiry of all contracts that are subject to position limits under the ASX 24 OR and Procedure 3400; and
  - monitoring the expiry of all contracts, whether deliverable or cash settled.

Each of these activities is integral to ASX’s operation of its futures clearing facility and performance of its statutory duties under Part 7.3 of the *Corporations Act 2001* (Cth). To effectively perform these monitoring activities, ASX relies on accurate information being submitted by each ASX 24 participant, so that it can develop a consistent and integrated view of client exposures to derivative market transactions.

The Contravention also potentially had a materially adverse impact on the fairness or effectiveness of the clearing facility operated by ASX Clear (Futures). Futures participants have a legitimate interest in the integrity of reported open interest figures. Reported open interest is used by traders, together with price and traded volume, to predict market trends and to gauge liquidity. Accordingly, any errors in the reporting of it negatively impacts the market and ASX 24’s reputation.

- (k) The Contravention arose in the context of an outsourced and offshore arrangement between BPS and the vendor. On 1 June 2015, ASX introduced streamlined admission and notification requirements for ASX’s markets and facilities. Included in these changes was the issue of a Guidance Note 9, relating to offshoring and outsourcing arrangements. As part of this process, ASX allowed existing participants a grace period of until 1 January 2016 to review and, if required,

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<sup>1</sup> As reported in [ASX notice 0516.17.05](#).

update their existing offshoring and outsourcing arrangements in order to align them with the updated requirements in that Guidance Note.

During ASX's investigation, BPS contested that its arrangements involved offshoring and outsourcing. This submission was plainly incorrect. The key elements of an outsourced arrangement are:

- an agreement between a participant and a third party;
- under which the third party will perform, on a continuing basis, a business activity on behalf of the participant; and
- that business activity is or could be undertaken by the participant itself.

The key elements of an offshore arrangement are:

- an arrangement entered into by a participant;
- whereby the participant arranges for a business activity to be conducted outside Australia;
- where that business activity is or could be undertaken by the participant in Australia.

BPS's contractual relationship with the vendor, permitting it to access software hosted by the vendor to process its data and prepare of its DBORs as and when they fall due, clearly meets the definition of an outsourced material business activity. Further, the software is hosted in Singapore, meaning that the work involved in converting BPS's input to a DBOR submission is conducted offshore.

#### *Contravention 5*

- (l) The comments at paragraph (j) above about the importance of DBOR data to the operation of ASX's clearing and settlement facility also apply to this Contravention.
- (m) Two of the relevant events, while occurring two months apart, had the same cause, largely because the vendor did not have resourcing to attend to the issue before mid-September 2017. This was an inappropriate response from BPS.

#### *Contravention 6*

- (n) ASX 24 OR 1000(e) and its related procedure support the regulatory function performed by ASX in the operation of its markets and facilities.

#### **Sanction Guidelines**

The CCO determined that given the circumstances in this matter a fine of \$100,000 (plus GST) was an appropriate sanction, comprising:

- \$35,000 in relation to Contraventions 1, 2 and 3;
- \$35,000 in relation to Contravention 4;
- \$20,000 in relation to Contravention 5; and
- \$10,000 in relation to Contravention 6.

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