

ASX Disciplinary Matter – Macquarie Equities Limited ('MEL')

ASX Limited's Chief Compliance Officer (the 'CCO') has determined that MEL did not comply with:

- ASX Settlement Operating Rule ('ASX SR') 6.3.5, which prohibits a Settlement Participant from holding the same Financial Product in a Settlement Holding or Accumulation Holding for longer than two Business Days (subject to certain exceptions) ('**Contravention 1**'); and
- ASX Settlement Operating Rules 4.3.1(h) / 4.18.1 / 6.1.1(a), being the obligation to have adequate resources and processes in place to comply with its obligations under those rules (the '**Organisational Competency Obligation**') ('**Contravention 2**'),

together, the '**Contraventions**'.

The CCO imposed a fine of \$80,000 (plus GST) for the Contraventions.

The circumstances of this matter are:

1. Over March and April 2018, MEL notified ASX that it had breached ASX SR 6.3.5 an indeterminate amount of times since the rule's antecedent was introduced in 2004.
2. A review of the period between 1 January 2017 and 27 March 2018 identified some 296 occasions on which stock remained in MEL's Settlement Account for longer than two business days, and that, in each case, the cause was the client failing to deliver funds to settle the trade, and MEL using its own funds to meet the outstanding settlement obligations.
3. The breaches were caused by the configuration of MEL's settlement system.
4. MEL concluded that its framework to identify and risk-rate key obligations and their related controls had not historically been applied to the requisite level of detail to capture all critical ASX obligations.
5. In response, MEL:
 - i. formally documented compliance plans in respect to its clearing and settlement obligations;
 - ii. bolstered its change management resourcing and introduced a Line 1 quarterly attestation and assurance process;
 - iii. commissioned two independent reports to review its arrangements for complying with the ASX SR and ASX Clear Operating Rules. Their findings were, in summary:
 - MEL's framework could better address the application of its principles to MEL's clearing and settlement activities and identify associated risks, and there was scope to improve processes to identify issues and improve controls and conduct change management.
 - Testing of line 1 processes and controls for 'high' and 'medium'-rated for the subsequent period (FY18/19) found no other exceptions prevailed. These were then mapped to controls for FY15/16, which were found to be substantially the same.

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

- (a) MEL elected not to contest the contravention and penalty.
- (b) ASX SR 6.3.5 forms part of a collection of rules regarding client asset protection that are in place to provide more certainty in the event of a default by the participant or another participant.
- (c) As set out in ASX Settlement Guidance Note 12:

“ASX Settlement Operating Rule 6.3.4(d) provides that a settlement participant must not use a settlement holding or an accumulation holding for custodial purposes unless it either obtains ASX’s written consent or an exception in Rule 6.3.5 applies. ...

Rule 6.3.4(d) serves two main policy objectives:

- *investor protection – it supports the participant’s underlying fiduciary obligations:*
 - *to account to clients for whose assets it is responsible on a timely basis; and*
 - *to minimise the co-mingling of client and house assets any more than is necessary for the operation of the daily CHESS settlement batch; and*
 - *operational efficiency – it assists the participant in tracking the client and house assets under its charge.”*
- (d) Over the 14 months reviewed by MEL, there were 296 instances where client assets were comingled with MEL’s assets. When extrapolated across a period of 14 years, this is a significant period where MEL was
 - comingling client assets when clients failed to provide the purchase price for those assets by the settlement date; and unaware of its obligation to move assets out of the settlement holding into the accumulation holding when clients fail to provide the purchase price by the settlement date.
 - (e) As the oversight underlying Contravention 1 persisted for 14 years, ASX is of the opinion that it arose as a result of negligence.
 - (f) Given the period over which the Contraventions occurred, ASX considers there to be sufficient basis on which to conclude that MEL did not have adequate processes to comply with ASX SR 6.3.5, in breach of the Organisational Competency Obligation in respect of that rule. This conclusion is supported by:
 - MEL’s Lines 2 and 3 processes for compliance and risk assurance did not identify the breach over the period it subsisted.
 - Prior to FY18, MEL did not have Line 1 operating procedures that incorporated appropriate controls to identify and prevent breaches of ASX SR 6.5.3.
 - An expert’s report found that MEL’s arrangements for monitoring compliance with its regulatory obligations were not explicitly directed to its clearing and settlement obligations.

Where ASX is satisfied on the evidence available to it that a participant’s breach of an operating rule is one which ought to have been prevented or mitigated by its arrangements for monitoring compliance with the operating rules, then it will consider a finding that the participant did not have adequate processes to comply with the relevant obligation to be appropriate.

Therefore, while it is clear that MEL was not without supervisory and monitoring arrangements, they do not appear to have provided effective oversight to ensure compliance with ASX SR 6.3.5.

- (g) The client asset protection rule framework was enhanced over two phases in 2014 and 2015. This included, amongst other things, the introduction of ASX SR 6.3A.3 (reconciliation of Accumulation Account Holdings). ASX would expect this change to prompt a participant such as MEL to review and confirm its compliance with the client asset protection provisions at the time (which included ASX SR 6.3.5). It appears that MEL failed to detect its system configuration error for ASX SR 6.3.5 at the time that regulatory change took place.
- (h) There is no evidence that:
- Any MEL client suffered loss or damage;
 - MEL derived a financial benefit or other commercial advantage from the Contraventions; and
 - MEL acted unconscionably toward, or unfairly took advantage of, clients or counterparties
- (i) The ongoing obligation of a participant under ASX SR 6.3.5 to have adequate processes is independent of other obligations under the ASX SR. Nevertheless, a breach of this obligation can be established co-extensively with a breach of another. That is, the facts comprising a breach of a rule will often establish that the participant did not have adequate processes to comply with that rule.

Where ASX makes such a finding, under the “totality principle” referred to in Annexure A to the Enforcement and Appeals Rulebook Procedures, it will consider whether a single penalty is appropriate in the circumstances, notwithstanding that an aggregation of penalties for each individual breach may be higher.

Sanction Guidelines

The CCO determined that, given the circumstances in this matter, a fine of \$80,000 (plus GST) was 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.