ASX Compliance Enforcement Activity

Under the Corporations Act, as a licensed operator of financial markets, ASX is obliged to have adequate arrangements for monitoring and enforcing compliance with the operating rules of those markets. It is also obliged, as a licensed operator of clearing and settlement facilities, to have adequate arrangements for supervising those facilities and for enforcing compliance with their operating rules.

The purpose of this circular is to notify participants in those markets and facilities of some of the enforcement activities recently undertaken by ASX Compliance, so that they are aware of potential areas of concern for ASX and of ASX's enforcement activities in those areas.

This circular covers enforcement activities that were finalised during the 3 month period ended 30 November 2018. Investigations in relation to other enforcement matters are ongoing.

Enforcement proceedings

ASX finalised two enforcement proceedings in the period.

The ASX Chief Compliance Officer (the "**CCO**") imposed a penalty of $30,000 (plus GST) on UBS Securities Australia Limited ("**UBS**") following its failure to promptly report a special crossing on two occasions in accordance with ASX Operating Rules ("**ASX OR**") 3500 and 1000(d) respectively.

Further details are available in the following ASX circular:

> https://www.asx.com.au/communications/notices/2018/UBS_Securities_Australia_Limited_enforcementcircular.pdf

The CCO also imposed a penalty of $15,000 (plus GST) by way of Alleged Minor Infringement Notice on a participant for a failure to comply with its obligation under ASX Clear Operating Rule ("**ASX CR**") to have adequate resources and processes to comply with its obligations under the rules. In this case, the participant's credit risk management ("**CRM**") function, which was located offshore with a foreign related body corporate, may not have received ongoing and complete data on the credit risk of a particular client in relation to Australian derivatives, because of an error in the logic in a data feed from the participant's booking system to the global CRM system. The participant's stress test exposure limit usage with respect to that client triggered ASX's warning levels on a number of occasions, prompting an investigation. ASX alleged that the participant failed to show that it had undergone appropriate testing to validate its functionality as a component of the CRM system it had implemented.

Compliance with capital requirements

ASX issued a warning letter to a participant relating to a breach of ASX CR 5.1.1 between 31 January and 12 March 2017.

ASX reviewed the entity's Rule S1 calculation spreadsheet for 31 March 2017 and identified that intercompany loans between it and two related entities were incorrectly categorised, impacting the total value of its liquid capital. ASX's calculations showed that the total value of the liquid capital was less than the total risk requirement, in breach of ASX CR 5.1.1 and S1.2.1(1)(a).

The participant engaged an independent expert to review its processes for Rule S1 calculations and undertook further steps in remediation, including undertaking to provide the daily Rule S1 calculation to its COO for sign-off and implementing a more rigorous process for calculating and checking the excluded assets calculation.

Compliance with reconciliation of client money and client segregation requirements

ASX has issued a warning letter to a participant relating to breaches of various rule obligations summarised below.

Event 1

In October 2017, ASX initiated a review of the participant's trust account reconciliation processes, which identified that:

a) A trust account reconciliation was not performed in the form provided in Appendix 1 of ASX Clear Guidance Note 12 for the business days 4 - 6 October 2017, in breach of ASX CR 4.23.6.

b) The correct close-of-business trust ledger balance (the "**Items in Trust Report**") was not used to perform the trust account reconciliation for the business days between 4 and 23 October 2017, in breach of ASX CR 4.23.6(a).

c) Key supporting documentation, namely the Items in Trust Report, was not retained for the business days 4 to 6 October 2017. The consequence of this was that it was not possible to verify whether sufficient client funds were held in the trust account for the stated period, in breach of ASX CR 4.23.6.

d) A reconciliation for business day 6 October 2017, which is the last business day of the week, was not performed in accordance with ASX CR 4.23.6(b), as the purported reconciliation did not reconcile the balance held by the participant on trust for each client and the corresponding balance as recorded in the its accounting records.

e) The trust account had a deficiency on the following business days as a result of interest payments being incorrectly charged to the trust account by its payment provider. The participant failed to identify and report the deficiencies as required, in breach of ASX CR 4.23.2 and 4.23.7.

Event 2

On the dates noted below, the participant self-reported a deficiency in the trust account pursuant to ASX CR 4.23.7. In all instances, the deficiencies were caused by dishonoured payments being incorrectly withdrawn from the trust account overnight by the payment provider. Each incident represented a breach of ASX CR 4.23.2.

Event 3

On 17 August 2018, the participant self-reported a potential trust breach, following which ASX also identified a potential breach of ASX Settlement Operating Rule ("**ASX SR**") 6.3B.2.

The matter related to a CHESS message for a sell transaction that was manually processed by the participant and was not conducted in accordance with its clearing system specification, resulting in the following implications:

a) A key accounting record required for the trust account reconciliation process, namely the Items in Trust Report, did not include the client funds relevant to the sell transaction, $26,516. Consequently, the trust account reconciliation performed (based on the Items in Trust Report) for business day 13 August 2018 was not accurate in all respects in breach of ASX CR 4.23.6.

b) As a result of the inaccurate accounting record issue above, the trust account had a deficiency of $26,516 on 13 August 2018, in breach of ASX CR 4.23.2.

c) When the participant manually sent the CHESS message to transfer the securities from its Accumulation Account to its Settlement Account it failed to include the 'Client Trust Receivable Amount', $26,516, in breach of ASX SR 6.3B.2.

d) The participant failed to ensure that the Client Trust Receivable Amount in respect of the sell contract, $26,516, was paid into the client trust account concurrent with batch settlement on the settlement day, 13 August 2018, in breach of ASX SR 6.3B.5.

Event 4

Further to the details stated in Event 3, ASX also identified that the trust account reconciliation performed for business day 10 August 2018 was not accurate as it failed to use the correct close of business balances for unpresented cheques and trust account balance, in breach of ASX CR 4.23.6(a).

Remediation

The participant has implemented a number of enhancements to its trust account reconciliation processes as the result of ASX's review, which include:

- revised trust account reconciliation processes to ensure the trust account reconciliation is performed in a form that is aligned with the sample form in Appendix 1 of Guidance Note 12;

- ensuring sufficient documentation is retained to support the trust account reconciliations; and

- engaging in discussion with its system vendor to implement a system set-up change and advising all staff on the relevant change.

ASX has also required the participant to:

- conduct regular independent reviews of its processes in relation to the review and sign-off of trust account reconciliations and accumulation account reconciliations, to ensure effective controls remain in place to ensure the accuracy of these reconciliations; and

- confirm in writing by 21 December 2018 that it has implemented the first action, along with details of any additional controls that the participant may have subsequently implemented.