



ACH Notice

Date: 29 February, 2008

Key topics

1. Merrill Lynch Equities (Australia) Limited.

Reading List

Client Advisers
Compliance Managers
ASTC Participants
Operations Managers (back office)
Share Registries
ACH Participants

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PARTICIPANT NOTICE

DISCIPLINARY MATTERS

The ACH Disciplinary Tribunal ("the Tribunal") has determined the following:

Merrill Lynch Equities (Australia) Limited ("MLEA") has been fined \$35,000 (plus GST) for contravening ACH Clearing Rule 5.1.1 (Applicable Capital Regime) during the period July 2006 to February 2007 inclusive ("the Relevant Period") as a result of the following failings:

- (i) Failure to comply with the requirement of S1.2.1(1)(a) of Schedule 1 to the Rules (Liquid Capital and Total Risk requirement) in that the monthly Capital Liquidity Returns (CLRs) for the Relevant period, and, the 2006 Annual Audited Return (2006 AAR), which MLEA prepared and submitted to ACH, did not accurately reflect its accounts and financial position;
- (ii) Failure to comply with the requirement of S1.2.2(1)(b) of Schedule 1 to the Rules (Notifying ACH), in that MLEA did not ensure that its Liquid Capital was at all times greater than its Total Risk Requirement, and;
- (iii) Failure to comply with the requirements of S1.2.10 (1) (b) of Schedule 1 to the Rules (Returns and Registers) in that MLEA did not notify ACH immediately when its Liquid Capital divided by its Total Risk Requirements was equal to or fell below 1.2.

MLEA did not contest the contravention before the Tribunal.

In determining the penalty to be imposed, the Tribunal also took into account the following matters:

- (a) The circumstances and facts of the matter;
- (b) MLEA identified the issue and self reported the issue to ASX Prudential risk Management;
- (c) When the ACH returns were restated, MLEA's Liquid Capital fell below its Total Risk Requirement for each month;
- (d) The contraventions were unintentional and an isolated instance (albeit one that continued undetected for 8 months);
- (e) Corrective action has been taken by MLEA to address the issue, including measures implemented to address the issue and control enhancements to ensure the accuracy of future returns;
- (f) MLEA co-operated with ASX in the investigations and resolution of the matter and elected not to contest the contraventions;
- (g) MLEA is a subsidiary of the Merrill Lynch group and the error had no impact on the consolidated position of the ultimate Australian parent company;
- (h) Tribunal precedents in similar matters.

The Circumstances of the matter

In July 2006, an outstanding error relating to an operational arrangement between MLEA and a related entity, along with an incorrect treatment of an unsecured asset resulted in incorrect ACH returns prepared and submitted by MLEA to ACH.

These errors meant that the CLRs and the 2006 AAR prepared and submitted by MLEA to ACH during the relevant Period did not accurately reflect its accounts and financial position. The Liquid Capital to Total Risk Requirements ratios prepared by MLEA had been overstated for each month.

On 10 May 2007, the errors were realised and MLEA self reported the problem to ASX Prudential Risk Management. MLEA corrected the errors and was required to restate the CLRS for the Relevant Period, and, the 2006 AAR.

When the inaccurate ACH returns were recalculated, the restated CLRs and restated 2006 AAR indicated that MLEA's Liquid Capital had not at all times been greater than its Total Risk Requirements and consequently, MLEA also did not immediately notify ACH when its Liquid Capital to Total Risk Requirement ratio fell below 1.2.

The Tribunal is of the view that Participants must manage situations where staff turnover creates a business risk and ensure that there is continuing ongoing compliance with ACH Clearing Rules. Further, the onus is on Participants to ensure correct and accurate regulatory reporting processes are in place. Reliance on related party accounts and reports is not considered appropriate or good practice.

The Tribunal notes that the Risk Based Capital Requirements are a fundamental aspect of the ACH's prudential regulation of its Participants. The failure to comply with those regulations has the potential to adversely affect the financial stability of Participants. Accordingly, the Tribunal views any breach of Risk Based Capital Requirements to be a matter of serious concern.