

**ASX Circular****Date:** 21 June 2012**Key topics**

1. ETRADE Australia Securities Limited

Reading List

Client Advisers
 Compliance Managers
 DTR Operators
 Managing Directors
 Office Managers
 Operations Managers (back office)

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ASX APPEAL TRIBUNAL MATTER

The Appeal Tribunal has fined ETRADE a total of **\$100,000** plus GST for a contravention of ASX Market Rule 13.4.1(b)(iii) (prevention of client-related manipulative trading).

The contravention was that on 31 March 2009 and on 1 April 2009, ETRADE entered a bid order into the ASX Trading Platform where, taking into account the circumstances of the orders, and the factors set out in Market Rule 13.4.2 to which ETRADE was required to have regard, ETRADE ought reasonably to have suspected that the client had placed the orders with the intention of creating a false and misleading appearance with respect to the price of ordinary shares in Company A.*

The Appeal Tribunal allowed an appeal by ETRADE against a higher penalty imposed by the Disciplinary Tribunal for the contravention. The Disciplinary Tribunal had found that the contravention was a Level 3 (very serious) contravention, whereas the Appeal Tribunal found that the contravention was properly characterised as a Level 2 (serious) contravention.

The indicative range for Level 2 contraventions is \$20,000 to \$100,000. The circumstances of the contravention and factors considered in determining an appropriate penalty are summarised below.

Particulars of the contravention

A summary of relevant facts, which were not disputed on appeal, follows:

1. During at least the period from 15 September 2008 to 1 April 2009, client 1 and client 2 were clients of ETRADE. As at 15 September 2008, they held 0.73% and 0.66% respectively of the issued shares of Company A. Client 1 gave instructions to ETRADE on behalf of both clients over the relevant period.
2. In January 2009:
 - i. Company B released an announcement over the ASX company announcement platform indicating that it intended to make an off-market takeover offer for all the issued shares in Company A; and
 - ii. Company A released an announcement stating that its board recommended rejecting the offer.
3. Between 13 January and 2 March 2009, the clients entered a number of orders into ETRADE's automated order processing ("AOP") system, resulting in the automatic entry of corresponding bids into the market. A number of these bids caused post-trade alerts by ETRADE's Compliance Explorer system. An ETRADE designated trading representative ("DTR") reviewed a number of these alerts but did not consider action necessary until 2 March 2009.

4. In March 2009:
 - i. Company B issued a bidder's statement in respect of its takeover offer; and
 - ii. Company A released a further announcement, again recommending rejection of Company B's offer.
5. On 2 March 2009:
 - i. a Compliance Explorer alert was generated in relation to the disproportionately large number of price increases generated by the clients' orders compared to the volume bought and the price movement in Company A; and
 - ii. the same ETRADE DTR reviewed the alert and contacted the client. During the conversation with the client, the client admitted supporting the stock. The DTR warned the client that such trading was inappropriate.
6. On 3 March 2009, the DTR emailed ETRADE's compliance department to inform them of the conversation with the client.
7. On 4 March 2009, ETRADE's compliance manager emailed ASX Surveillance to inform ASX that ETRADE had detected possible ramping in Company A and also of the DTR's conversation with the client.
8. Around four weeks later, on 31 March 2009, at approximately 12:26, client 1 placed an order into ETRADE's AOP system to buy 10,000 Company A at \$0.080 and a corresponding bid was accordingly entered into the market. The Bid/Ask/Last for Company A immediately prior to the entry of bid was 0.071/0.070/0.070.
9. On 1 April 2009:
 - i. at approximately 10:38, client 1 placed an order into ETRADE's AOP system to buy 12,000 Company A at \$0.090 and a bid was accordingly entered directly into the market ("subsequent bid"). The Bid/Ask/Last for Company A immediately prior to the entry of the subsequent bid was 0.071/0.094/0.080; and
 - ii. at approximately 17:27, the ETRADE compliance manager emailed ASX Surveillance to inform ASX that ETRADE had detected ramping again in the shares of Company A and that it had closed the relevant accounts of client 1 and client 2.

Factors considered by the Appeal Tribunal

The Appeal Tribunal had regard to the Principal Factors and the Category of Seriousness Tables set out in Annexure A to the Disciplinary Processes and Appeals Rulebook procedures, as they applied at the time of the contravention. Annexure A provides a tool to assist the Tribunal in setting appropriate penalties and promoting consistency of penalties for contraventions of the Rules in comparable circumstances.

In determining penalty, the Appeal Tribunal took into account a number of factors, including those set out below:

- although 'market manipulation' is specified in Annexure A under the Level 3 classification, a breach by a Market Participant of Market Rule 13.4.1(b)(iii) does not necessarily amount to market manipulation by the Market Participant. Market Rule 13.4.1(b)(iii) protects against actual or suspected market manipulation;
- the contravention did not match any of the other "characteristics of conduct" listed in column 1 of the Category Tables as being indicative of a Level 3 (very serious) contravention;
- the contravention constituted a repeat offence but was not systemic or indicative of a pattern of non-compliance. The Appeal Tribunal considered, after taking into account the nature of the contravention, ETRADE's disciplinary history and previous disciplinary penalties imposed on other Market Participants (as detailed below), that although this characteristic is a seriously aggravating factor, the contravention is more appropriately classified within the Level 2 range;
- failure by ETRADE to prevent the bids from being entered into the market in the circumstances of the contravention is properly categorised as grossly negligent or reckless, but not deliberate. Again the Appeal Tribunal saw this as a seriously aggravating factor but not sufficient alone or in combination with other factors to elevate the contravention to Level 3;

- the Contravention gave rise to a potential for damage or loss to third parties, being such persons who may have subsequently sold Company A at prices elevated due to, and influenced by, the initial and subsequent bids; and
- the Contraventions had the potential to threaten the integrity and efficiency of the market.

The Appeal Tribunal considered that the circumstances of the contraventions fell short of demonstrating a failure by ETRADE to understand its obligations under Market Rule 13.4.1(b)(iii). The evidence before the Tribunal indicated that ETRADE did understand its obligations to prevent manipulative trading and had systems in place to identify grounds for suspecting such trading. ETRADE's initial acts in responding to the alerts and advising thereafter to permit the continued trades constituted a failure by ETRADE in managing its obligations rather than a lack of understanding. However, ETRADE did show a failure to adequately deal with those obligations by considering and using all the technical resources that may have been available to it (for instance by referring trades to a DTR). The Appeal Tribunal considers this to be a seriously aggravating factor but of less significance than if there had been a "complete disregard for the rules" or a lack of understanding of ETRADE's obligations.

In mitigation, the Appeal Tribunal had regard to ETRADE's co-operation and assistance with ASX's investigation of the matter, ETRADE's reports to ASX of 4 March and 1 April 2009 and its closure of the clients' accounts on 1 April 2009.

Other circulars considered by the Appeal Tribunal

The Appeal Tribunal considered a number of previous comparable penalties.

- Hartleys Limited (181/10), which was a level 2 (serious) contravention involved a single bid in a security that two days prior had been the subject of an ASX market alert, warning Participants that the security was recently the subject of potentially manipulative trading. The bid was entered into at 16:04 and caused a 100 per cent price increase in the security.
- Macquarie Equities Limited (064/11), which was a level 2 (serious) contravention, involved 14 offers in a security during the last 20 minutes of trading, some of which triggered alerts to Macquarie Equities, in circumstances where an ASX announcement had been released that alerted the market to the client's significant holdings in options over the security and detailed the exercise price conditions of the security.
- Morrison Securities Pty Ltd (063/11), also a level 2 (serious) contravention, involved two contraventions of Market Rule 13.4.1(b)(iii) within two weeks by the same client, in circumstances where Morrison Securities' DTR had reasons to review the trading by the client and where Morrison Securities had been informed by ASX Surveillance that an investigation was taking place in relation to the first instance of trading by the client.
- Commonwealth Securities Limited (106/11), a level 2 (serious) contravention, involved a number of contraventions, in which Commonwealth Securities ultimately failed to have in place adequate arrangements to prevent trading by clients through both manual and automated client order processing ('ACOP') orders that had the potential to interfere with the efficiency or integrity of the market.

The Appeal Tribunal was also referred to the Tricom Equities Limited matter (230/09) circular, a Level 3 (very serious) contravention of Market Rule 13.4.1(b)(iii), which concerned a large number of trades throughout an extended period of time, and involved deliberate and manipulative conduct. The Appeal Tribunal considered the facts in the Tricom matter represented an extreme case and was of little assistance in the present proceedings.

Finally, the Appeal Tribunal noted and endorsed the following comments of the Disciplinary Tribunal in its liability determination, in relation to the application of Market Rule 13.4 to direct market and AOP contraventions:

"...Rule 13.4 as a whole leaves no room at all, in the opinion of the Tribunal, for a submission that Rule 13.4 applies with lesser force or practical effect, to direct market or AOP traders, where the trade executes immediately."

The Appeal Tribunal ordered:

- ETRADE is to pay a total fine of \$100,000 (plus GST) in respect of the contravention; and
- This disciplinary circular is to be publicly announced to Market Participants.

The Tribunal is of the opinion that this sanction will act as a deterrent and appropriately serves the interests of ASX and Market Participants in maintaining a market that is fair, orderly and transparent.

* References to Company A and Company B are securities in separate ASX-listed entities.

On 1 August 2010, the supervision of trading on Australia's domestic licensed markets and the supervision of trading participants transferred from ASX to the Australian Securities and Investments Commission. The conduct that is the subject of these contraventions occurred prior to the transfer date. ASX will continue to manage, and bring before the Tribunal, disciplinary matters for potential breaches of its operating rules occurring before the transfer date.

As part of the transfer, a number of changes were made to the rules, including the replacement of the ASX Market Rules by the ASX Operating Rules. Potential operating rule breaches which occurred prior to 1 August 2010 will be dealt with in accordance with the rules in place at the time of the alleged breach.