



ASX Circular

Date: 27 May 2009

Key topics

1. State One Stockbroking Limited

Reading List

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

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DISCIPLINARY MATTERS

The Appeal Tribunal has allowed an appeal by ASX and increased from \$40,000 to \$100,000 a penalty imposed by the Disciplinary Tribunal on State One Stockbroking Limited ('SOSL') for manipulative trading that created a false and misleading appearance with respect to the market as a result of four (4) non-genuine bids made by traders employed by SOSL.

All other appeals on penalty by both ASX and SOSL were dismissed.

The result of the Appeal is that the total fines imposed on SOSL were increased from \$175,000 to \$235,000 plus GST.

The Disciplinary Tribunal had made the following determinations:

- (a) NCBO Transactions
 SOSL contravened ASX Market Rule 13.4.1(a) in that it failed to ensure that it did not make Bids, Offers for, or deal in, any Product as Principal where those Bids, Offers or dealings had the effect or were likely to have the effect of creating a false or misleading appearance of active trading in any Product.

For this contravention the Disciplinary Tribunal imposed a fine of \$35,000 plus GST.

- (b) Unprofessional Conduct
 SOSL contravened ASX Market Rule 4.1.1(w) in that it, as a Market Participant, engaged in Unprofessional Conduct where the conduct involved a substantial or consistent failure to reach reasonable standards of competence and diligence.

For this contravention the Disciplinary Tribunal imposed a fine of \$100,000 plus GST.

- (c) Manipulative Trading
 SOSL contravened ASX Market Rule 13.4.1 in that as Principal it made Bids, Offers for and dealt in Products which had the effect of creating a false or misleading appearance of active trading in those Products or with respect to the market for, or the price of those Products

For this contravention the Disciplinary Tribunal imposed a fine of \$40,000 plus GST which the Appeal Tribunal increased to \$100,000 plus GST.

Facts and findings by the Disciplinary Tribunal

Between 2 October 2006 and 15 March 2007, SOSL entered into over 3033 market transactions involving no change of beneficial ownership ('NCBO transactions') which remained uncanceled in a variety of securities. The transactions were carried out by employees of SOSL acting as day traders trading as Principal on SOSL accounts which they individually managed. Profits were divided between the traders and SOSL. It was

alleged that, because the transactions involved no change of beneficial ownership, they thereby created a false or misleading appearance with respect to the market in breach of Rule 13.4.1. SOSL admitted this contravention. Further, on nine other occasions during this period SOSL entered into transactions that did not involve any change in beneficial ownership. SOSL did not contest this contravention.

SOSL was guilty of unprofessional conduct because it did not respond adequately when ASX Surveillance first brought the NCBO transactions to its attention, and did not have appropriate management structures to ensure that it had operations and processes in place that were reasonably designed and implemented and functioned so as to achieve compliance with ASX Market Rules. SOSL denied the allegation of unprofessional conduct, but the Disciplinary Tribunal found the contravention proved.

Further, between 7 November 2006 and 1 December 2006, SOSL operators entered four small volume bids (typically 10 or 100 shares) above the existing priority bid price. It was alleged that each bid was not made with a genuine desire to acquire the shares, but was made for the purpose of increasing the priority bid price in the market to enable SOSL to sell a much larger parcel of shares at the new and higher priority bid price that had resulted from its original non-genuine bid for an insignificant quantity. SOSL denied this contravention, but the Disciplinary Tribunal found the contravention proved.

Findings by Appeal Tribunal

The ASX Market Rules are intended to reflect the high standards of commercial probity that are expected of licensed Market Participants. Participants are in a position to influence the operation of the market. Their responsibilities to the ASX and the market are significant. They should expect that contraventions involving any dishonesty, lack of probity or unprofessional conduct will result in very substantial penalties. Conduct of that nature may be prejudicial to the interests of the ASX as the licensed market operator. It will often be likely to undermine trust and confidence in the market.

The importance to the community of a fair, orderly and transparent financial market operating through licensed Participants who conduct their affairs honestly, and in accordance with the Operating Rules that bind them, cannot be overstated. The Operating Rules of ASX, other than the Listing Rules, constitute a contract under seal between ASX and each Participant and between each Participant and all other Participants. The importance of compliance with the Operating Rules is reflected in the fact that ASIC, ASX or a person aggrieved, among others, may apply to the Court for orders enforcing the rules against a licensed Participant.

In those circumstances, it is both understandable and appropriate that penalties for contraventions by licensed Participants, particularly those involving any dishonesty, lack of probity or unprofessional conduct, should be substantial. In determining what is substantial in any particular case, disciplinary tribunals should have regard to two overarching and well established factors:

- (a) First, the penalty should constitute a real punishment proportionate to the deliberation, or degree of recklessness, with which the contravention occurred. A "punishment", by definition, involves pain or loss. It will not do so unless it is set at a realistic level. In the case of wilfully dishonest or recklessly careless conduct, the punishment will naturally be greater than in the case of conduct that is merely inadvertent. But in both cases, the penalty should constitute an actual punishment.
- (b) Second, the penalty should have a deterrent quality. It should be set at a level that is capable of influencing, and is genuinely intended to influence, the conduct of other Participants. It should be such as to realistically deter others who might otherwise engage in similar conduct, whilst recognising that in any individual case, allowance may have to be made for mitigating factors and other circumstances relevant to the particular Participant.

These factors, among others, are reflected in Guidance Note 18, which was applicable to the facts of this case. The Appeal Tribunal regards the two factors identified above as being primary requisites of an appropriate penalty.

The Disciplinary Processes and Appeals Rulebook ('the Rulebook'), which is not applicable to this case and only applies to conduct occurring from 31 March 2008, adopts similar principles. However, there is one significant difference. The principles and guidelines applicable from 31 March 2008 are incorporated into the Rulebook, whereas prior to 31 March

2008, the principles and guidelines existing outside the rules in a Guidance Note had no legally binding effect. The Rulebook forms part of the Operating Rules of the ASX and thereby constitutes part of the contract between ASX and each Participant and between each Participant and all other Participants. The maximum penalty that may be imposed by the Tribunal has been increased under the Rulebook to \$1 million, further emphasising the necessity for a penalty to constitute an actual punishment.

In future proceedings involving conduct occurring after 31 March 2008, the applicable guidelines will be those contained in the Rulebook, which forms part of the Operating Rules and will thereby be legally binding. In those circumstances, although they remain no more than guidelines and must yield to the particular circumstances of any given case, the Appeal Tribunal will be in a position more readily to find error by a Disciplinary Tribunal if a penalty is imposed that is predicated on a classification of conduct that is inconsistent with the guidelines. The Appeal Tribunal recommended that future submissions on penalty refer to the Categories of Seriousness Table in the Rulebook and specifically to the characteristics of the conduct.

The Appeal Tribunal also addressed the topic of financial capacity, which was raised as a mitigating factor in this matter. It held that in rare cases, the financial capacity of a Market Participant to meet any proposed penalty may be relevant to the assessment of an amount that is appropriate in the circumstances. The Appeal Tribunal does not expect that such a submission will often be justified. Nor does it think that such a submission should be encouraged. The fact that a penalty may result in hardship to a Participant is one of the very objects which an appropriate penalty is designed to achieve.

An appropriate penalty should be both punitive and remedial, as well as having a deterrent quality. In this case, it mattered not that there were only four bids and that the amounts involved were small. The conduct of SOSL's day traders was of the type that could undermine trust and confidence in the market and it should be punished accordingly. The penalty should constitute a real deterrent to other Participants whose systems and procedures may permit similar behaviour by traders.

The Appeal Tribunal added that it was satisfied that the Executive Chairman of SOSL was not personally involved in the contraventions. His integrity was not in issue. It also accepted that he showed contrition for what had occurred and that steps had been taken by SOSL to reform its procedures to minimise or prevent the recurrence of any conduct similar to that which gave rise to the contraventions. However, the Appeal Tribunal added that none of the matters was sufficient to persuade it that anything less than a \$100,000 penalty was appropriate for the false and misleading conduct arising out of the four non-genuine bids.