SFE NOTICE NO. 157/06

Date of Issue: 21/12/2006
Effective Date: 21/12/2006

Disciplinary Action Imposed by the Business Conduct Committee Upon BrokerOne Pty Limited

Pursuant to Operating Rule 5.12, Sydney Futures Exchange Limited (the Exchange) advises that its Business Conduct Committee (the Committee) has determined the following:

BrokerOne Pty Limited (BrokerOne) has been fined $25,000 (exclusive of GST) for a failure to comply with the following:

(i) Operating Rule 2.2.13
[Prudent Risk Management].

In addition, the BCC directed that Exchange staff conduct a targeted follow-up inspection of BrokerOne's compliance with the requirements of Operating Rule 2.2.13(a) within three (3) months.

The above failure to comply was highlighted following receipt by SFE of a complaint from another market Participant who expressed concern regarding activity in the June 2006 90 Day Bank Accepted Bill Futures Contract (IRM6) on trade date 24 February 2006. Preliminary investigations by SFE determined that a Client of BrokerOne was responsible for the activity via an electronic trading system which although provided by another Exchange Participant provided BrokerOne with risk management access to modify limits and the obligation for BrokerOne to accept all trades executed by its client.

In relation to the activity, Exchange Compliance & Surveillance staff identified that the Client had progressively built up very large potential positions in its order book. These potential positions comprised multiple orders at, and close to, the current bid and/or offer and at times represented up to 60% of the June 2006 90 Day Bank Accepted Bill Futures Contract's tradeable volume.

Exchange Compliance & Surveillance staff also found that over the period from 20 January to 2 March 2006, the Client's trading limits had been increased by BrokerOne on several occasions. The Client's limits were originally set in the 90 Day Bank Accepted Bill Futures contract at two thousand (2,000) lots per order with a maximum long/short position of seven thousand (7,000). At the time of the incident, the Client's limits were set at three thousand (3,000) lots per order with a maximum long/short position of twenty thousand (20,000).

Over this same period, the Client had created order books with a potential Initial Margin obligation in excess of $22M. At the same time, the Client had a potential exposure of over $700,000 per point.

In making its determination, the Committee was of the view that the Participant failed to assess the Client's requests for limit increases in a prudently responsible manner and failed to effectively monitor the activities of its Client. Irrespective of the fact that the orders related to the incident were not executed, the Committee was of the view that the obligations outlined under Operating Rule 2.2.13 were breached in that the limits and controls in place did not meet the Exchange's requirements for prudential risk management. The Committee noted that had the orders traded up to the available limits, coupled with an adverse market movement, the potential loss would have greatly exceeded the Client's net worth, as assessed by the Participant.

In making its determination as to penalty (including its recommendation of public notification of the disciplinary action taken), the Committee took into account the following key factors:

- The magnitude of the potential financial impact and/or reputational risk for BrokerOne, its guarantor Clearing Participant and the Exchange arising out of BrokerOne's Client's actions; and
- That public notification would more effectively reinforce to BrokerOne and the market the seriousness with which the Committee viewed the incident and the importance of Participants maintaining prudent and pro-active risk management of trading activity.

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