

Market Abuse Case Studies

Westpac Primary Market Manipulation

Market Abuse Case Study No: 001	Name: Westpac Banking Corporation
Offence: Front running and insider trading in interest rate derivatives and swaps	Detection Control: Front Running V2 (Deal Specific Facilitation)

 TradingHub

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Civilian Authority:
The Australian Securities and
Investment Commission (ASIC)

Offence:
Front running and insider
trading in interest rate
derivatives and swaps

Detection Control:
Front Running V2 (Deal Specific
Facilitation)

Overview

On 31 January 2024, the Australian Federal Court declared Westpac Banking Corporation (Westpac) engaged in unconscionable conduct in October 2016 when Westpac entered into hundreds of transactions (876) in various Australian dollar Interest Rate Derivatives (IRDs) hours before trading c. AUD 12bn of interest rate swaps with a Special Purpose Vehicle (SPV) being used by a consortium of investors for the purchase of a majority stake in Ausgrid (the “Swap Deal”).

Ausgrid is an electricity distribution company with 1.8 million customers in New South Wales, and the purpose of the interest rate swaps were to hedge floating rate interest rate payments due on loans borrowed by the SPV to part fund the AUD 16.2bn acquisition of 50.4% of Ausgrid sold in a part-privatisation by the Government of New South Wales.

The application Westpac will pay the maximum penalty of \$1.8 million in relation to the conduct, together with \$8 million for the Australian Securities and Investment Commission’s (ASIC) litigation and investigation costs. The case stems from an application filed by ASIC, which claims that Westpac took advantage of inside information relating to the Ausgrid part-privatisation when trading the various IRDs in advance of the Swap Deal with and without the consortium’s knowledge.

ASIC’s grounds for proceedings

There are three critical grounds to ASIC’s proceedings which are that:

- Westpac committed 876 cases of insider trading because it possessed inside information relating to the Ausgrid transaction and took advantage (without the consortium’s consent or knowledge) of this information via 876 IRD transactions.
- Westpac’s 876 IRD transactions likely influenced the execution price of the Swap Deal (contravening 12CB of the ASIC Act).
- Westpac did not do all things to ensure that the Swap Deal was executed efficiently, honestly, and fairly (contrary to section 912A of the Corporations Act).

Transaction details & alleged harm

The Swap Deal comprised of 11 interest rate swaps totalling c. AUD 12bn in notional amortising over a 10-year period. These swaps involved Westpac paying a floating rate in return for a fixed rate from the consortium’s SPV. The purpose being to transform the consortium’s debt servicing costs on syndicated debt funding into fixed cashflows.

Prior to execution, Westpac had agreed with the consortium’s SPV to price the swap deal using a formula that referenced the prevailing market levels of related financial products plus an execution margin.

The goal of the formula was to ensure that the price of the Swap

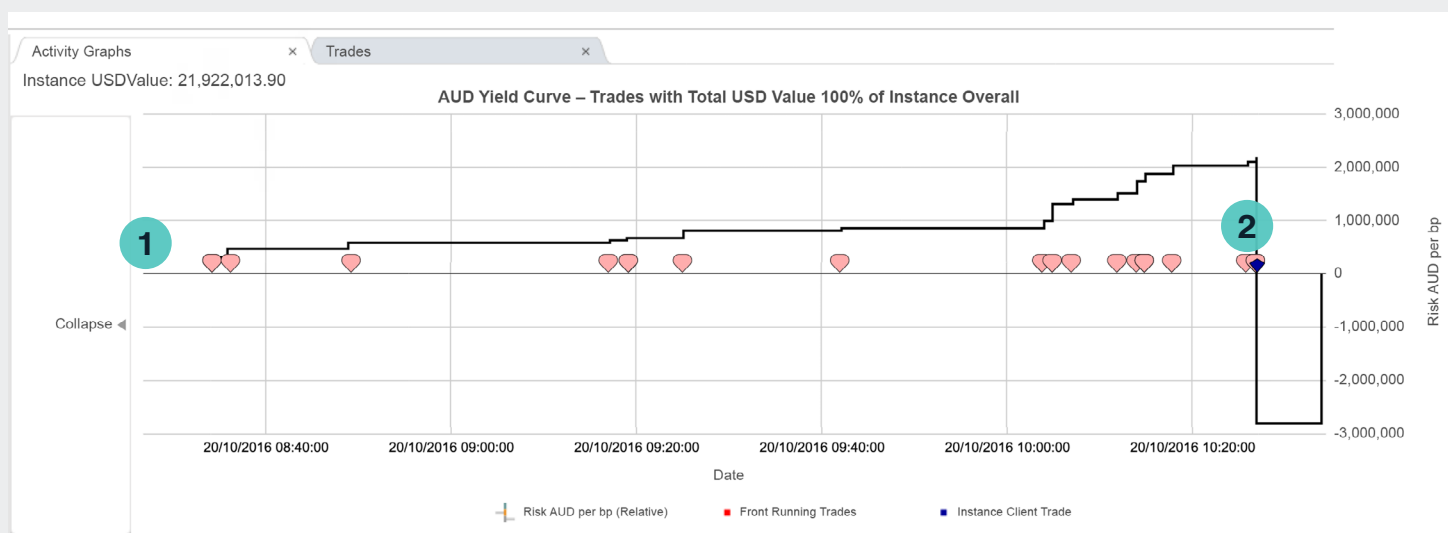
Deal occurred at a level consistent with market levels prevailing at the precise time that the Swap Deal was executed (10:27 am AEST). Furthermore, it incorporated an execution margin to cover Westpac's hedging costs and a reasonable profit on the transaction.

The court found that Westpac began to hedge the Swap Deal before it had been priced and executed via the 876 IRDs. These IRDs comprised of:

- Sells of 692 Australian government bond futures contracts (totalling AUD 3.59bn 3-year & AUD 818.9m 10-year contracts).
- Sells of 128 Australian dollar 90-day interest rate futures contracts (totalling AUD 6.109bn and expiring in Sep '17, Dec '17, Mar '18 and Sep '18).
- 35 Exchange for Physicals (EFPs) transactions where an aggregate of AUD 3.98bn of short positions in Australian government bond futures were exchanged for 3, 5 & 10-year Australian dollar interest rate swaps (Westpac paying fixed vs. receiving floating).
- 21 Australian dollar 6s3s tenor basis swaps totalling AUD 2.075bn in 5, 7 & 10-year maturities.

These transactions were executed between 8:30 am & 10:27 AEST and appear to have been designed to hedge up to 50% of the interest rate risk originating from the cash flows of the Swap Deal. ASIC charged and the court concurred that the market moved detrimentally to the consortium as a direct result of this pre-hedging, and consequently, the quoted rate and execution price of the Swap Deal were subsequently fixed at a worse price to the consortium (and a better price for Westpac) than would otherwise have occurred.

Detecting Primary Market Manipulation in MAST



This scenario has been calculated and run through MAST. The graph screenshot shows how MAST illustrates the changing risk position within the instance.

1. The line graph and associated red markers show the build-up of the interest rate risk position from the bond futures trades during the pre-hedging activity.
2. The consortium trade is highlighted by a blue diamond and shows a corresponding fall in the interest rate risk position when the Swap Deal is executed at 10.27 am AEST.

Activity Graphs

Trades

Show Relevant Trades

Show All Trades

Trade Date	Client Instrument ID	USDValue ? ▼	Trade Designation ?	Amount
20/10/2016 08:34:00	AUD 3Y Bond Future	2,833,229.40	WestPac Trades	600,000,000
20/10/2016 08:34:00	AUD 3M Bond Future	87,181.72	WestPac Trades	2,000,000,000
20/10/2016 08:34:00	AUD 3M Bond Future	28,729.37	WestPac Trades	664,000,000
20/10/2016 08:34:00	AUD 3M Bond Future	85,893.28	WestPac Trades	2,000,000,000
20/10/2016 08:36:00	AUD 3Y Bond Future	1,841,148.10	WestPac Trades	500,000,000
20/10/2016 08:49:00	AUD 10Y Bond Future	1,395,923.49	WestPac Trades	100,000,000
20/10/2016 08:49:00	AUD 3M Bond Future	3,401.93	WestPac Trades	109,000,000
20/10/2016 09:17:00	AUD 10Y Bond Future	154,603.51	WestPac Trades	10,000,000
20/10/2016 09:19:00	AUD 10Y Bond Future	303,257.26	WestPac Trades	20,000,000
20/10/2016 09:19:00	AUD 10Y Bond Future	480,362.22	WestPac Trades	33,600,000
20/10/2016 09:25:00	AUD 3Y Bond Future	1,930,569.94	WestPac Trades	500,000,000
20/10/2016 09:42:00	AUD 3M Bond Future	118,161.83	WestPac Trades	1,336,000,000
20/10/2016 10:04:00	AUD 3Y Bond Future	3,229,274.57	WestPac Trades	490,200,000
20/10/2016 10:05:00	AUD 3Y Bond Future	4,246,773.81	WestPac Trades	999,900,000
20/10/2016 10:05:00	AUD 3Y Bond Future	300.18	WestPac Trades	100,000
20/10/2016 10:07:00	AUD 10Y Bond Future	558,948.51	WestPac Trades	69,100,000
20/10/2016 10:12:00	AUD 10Y Bond Future	755,293.15	WestPac Trades	100,000,000
20/10/2016 10:12:00	AUD 10Y Bond Future	108,576.73	WestPac Trades	15,400,000
20/10/2016 10:14:00	AUD 10Y Bond Future	1,277,736.66	WestPac Trades	200,000,000
20/10/2016 10:15:00	AUD 10Y Bond Future	284,135.45	WestPac Trades	50,000,000
20/10/2016 10:15:00	AUD 10Y Bond Future	271,364.89	WestPac Trades	50,000,000
20/10/2016 10:15:00	AUD 10Y Bond Future	109,539.97	WestPac Trades	20,800,000
20/10/2016 10:18:00	AUD 3Y Bond Future	1,078,032.75	WestPac Trades	500,000,000
20/10/2016 10:26:00	AUD 10Y Bond Future	254,155.61	WestPac Trades	50,000,000
20/10/2016 10:27:00	AUD 10Y Bond Future	247,327.78	WestPac Trades	50,000,000
20/10/2016 10:27:00	AUD 10Y Bond Future	238,091.79	WestPac Trades	50,000,000
20/10/2016 10:27:05	Swap Deal	21,922,013.90	Consortium Trade	- 11,931,000,000

The trade screenshot shows how MAST illustrates the critical trading activity within the instance.

1. The trader sold bond future transactions throughout the morning up until the Swap Deal execution time.
2. The Swap Deal was executed at 10.27 am AEST using the prevailing market levels during the pricing window.
3. MAST calculated the impact of each alleged front running trade and assigned a total instance USD value of \$21,922,013.90.

How MAST recognises Primary Market Manipulation

Where pre-hedging of a customer order is not permitted (for example, a related transaction in a primary market deal), MAST analyses the trader's activity prior to the execution of the customer's order. MAST uses its Market Impact Model (MIM) and General Market Model (GMM) to determine and quantify whether the trader's activity is likely to have affected the market and corresponding execution price of the customer order.

Where the trader's activity is expected to have affected the order execution price, MAST will express the gain to the trader as a USD Value. An alert will be generated when the materiality score (USD Value) exceeds a pre-set threshold amount.

MAST's market impact and general market models evaluate cross-product market impact (meaning that the impact of futures trades on swap market prices is covered). Furthermore, evaluation of the market impact on the customer's order considers the timing and size of trades.

Advance your surveillance function

Detect cross-product abuse,
reduce false positives, and
prioritise high-risk alerts.

Reach out to learn more.



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