

16 January 2017

**N01/17**

## **Disciplinary action against a member firm - public censure and fine - Cornhill Capital Limited**

### **Introduction**

1. The London Stock Exchange (“the Exchange”) announces that, for the reasons listed below and based on the facts and matters set out below, on 9 January 2017 the Exchange’s Disciplinary Committee, appointed pursuant to Rule C300 of the Rules of the London Stock Exchange (“the Rules”), approved a Consent Order agreed between the Exchange and Cornhill Capital Limited (“Cornhill” or “the firm”). Cornhill has been publicly censured and fined £300,000 by the Disciplinary Committee. The fine has been discounted for early settlement to £210,000.

### **Summary**

2. This censure relates to breaches of Rules 1020 (Suitability), 1060 (Trade confirmations), 1400 (Misleading acts, conduct and prohibited practices) and 5000 (Obligation to settle) which took place between April 2015 and July 2015 when Cornhill was the placing agent for New World Oil and Gas Plc (“NEW”), a company that was admitted to trading on AIM, for a Placing announced on 28 April 2015 (“Placing”). The Placing was conditional, in that it was subject to a vote at an EGM on 19 May 2015. At the time that the Placing was announced, NEW had 702,723,713 shares in issue. If the Placing was approved by shareholders at the EGM on 19 May 2015, a further 2,727,272,727 shares were to be issued by NEW on 20 May 2015.
3. Following the Placing announcement, Cornhill forward sold on behalf of its underlying customers a significant quantity of placing shares for settlement on 20 May 2015. These sales by Cornhill were on Exchange and were unconditional. As such, the firm became wholly reliant on the Placing being approved by shareholders at the EGM in order to settle its position. The Placing was not approved by shareholders of NEW at the EGM and Cornhill was unable to settle its forward sales. As a result of the settlement situation which ensued, the trading in NEW shares was suspended until such time as a second placing and open offer was concluded by NEW some two months later.

### **The Findings**

4. Cornhill breached Rule 1020.3 and the guidance to Rule 1400 in that the firm did not have adequate internal procedures and controls in place to manage its forward selling in NEW to an amount of shares that it would be able to settle in the event that the Placing was not approved by shareholders, or have a clear and viable strategy in that contingency.

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# Market Notice

16 January 2017

5. By entering into its forward sales of NEW shares and failing to ensure that these trades were able to be duly settled, Cornhill took actions and/or engaged in a course of conduct which was likely to damage the fairness or integrity of the Exchange's markets and caused, or contributed to, a breach of the Exchange's Rules by other member firms in breach of Rules 1400.4 and 1400.5.
6. There was price volatility in the market as the presence of the substantial uncovered short position (which was dependent upon the approval of the Placing resolution at the EGM) was identified in the market. An increasing settlement backlog developed in NEW between 5 May 2015 and 19 May 2015 such that it was necessary for the Exchange to issue four Stock Exchange Notices and the Exchange suspended the trading of NEW under Rule 1510 on 21 May 2015 due to the settlement situation.
7. When the Placing failed to pass at the EGM, there was a substantial increase in unsettled transactions in NEW, including Cornhill's forward sales. This resulted in the firm breaching Rule 5000 (Obligation to settle). As a result of the firm being unable to settle its sales in the market, other member firms were unable to settle their own onward sales where settlement was dependent on the receipt of stock from Cornhill (thereby also breaching Rule 5000).
8. The settlement situation in NEW shares had a detrimental impact on NEW, its shareholders and other market participants as it caused trading in the security to be suspended for approximately eight weeks until a consequent second placing and open offer had concluded and the settlement situation had improved. Settlement of outstanding trades did not occur until some two months after the original settlement due date.
9. In addition, Cornhill breached Rule 1060 in that some of its trade confirmations stated that the trade was subject to the Rules when the trades themselves were not executed on Exchange. Rule 1060 requires member firms not to inform a customer that a trade is subject to the Rules unless the trade is on Exchange.
10. In reaching its decision to settle the disciplinary action by way of a Consent Order, the Exchange has also taken into account:
  - that there was no intent by Cornhill, rather the issues arose as a result of inadequate systems and controls;
  - that Cornhill co-operated fully with the Exchange's investigation;
  - that the firm does not have any historic issues on its compliance record;
  - that Cornhill has provided assurances that substantive remedial measures have been taken to ensure that such breaches do not reoccur, including extensive remedial work to its systems and controls; and

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# Market Notice

16 January 2017

- that Cornhill has confirmed, that it has voluntarily compensated those of its advisory clients that suffered losses as a result of their trades in NEW, at a financial cost.

## Guidance to member firms

11. In light of this case and the Exchange's experience of other recent corporate action events, member firms are reminded of their obligations under the Rules in two specific areas:
  - (a) The guidance to Rule 1400 in respect of their monitoring of trading and settlement positions. This guidance specifies that member firms should have adequate systems and controls in place to ensure that their business is conducted and settled in accordance with the Exchange's rules. This guidance goes on to state that these "systems should enable member firms to monitor trading positions (long and short), identify stock shortages, settlement delays or backlogs" and to "have a clear strategy for ensuring the settlement of their short positions."

Member firms should ensure that their internal systems and controls are sufficiently robust so as to be able to identify and alert the firm when a trading position in a security becomes mismatched with the firm's settlement position in that security. For example, a member firm may have a relatively flat trading position in a security but at the same time have a severe settlement backlog, either because the firm has not received delivery of stock due to failed purchases, or is awaiting settlement of purchases which were traded for extended settlement.

Monitoring of positions should also:

- (i) reference the number of shares in issue; and
- (ii) be undertaken regardless of the monetary value of a particular position.

An unsettled position can be of low monetary value to a firm, however, in terms of the number of shares in issue, the unsettled position may be significant in terms of the impact it has on the firm's counterparties and the overall settlement situation in the market.

This is particularly relevant where the company may have an upcoming corporate action which is subject to a shareholder vote. As referenced above, member firms should have a clear strategy for ensuring settlement of any short position.

- (b) In respect of paragraph 9 above, member firms are reminded to ensure that, in respect of their trade confirmations and in accordance with Rule 1060, customers are not informed that a trade is subject to the Exchange's rules unless the trade itself is on Exchange.

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# Market Notice

16 January 2017

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