

**Participant Circular****Date:** 16 June, 2003**Key topics**

1. Reynolds & Co Pty Limited
2. Bridges Financial Services Pty Limited
3. Shaw Stockbroking Limited
4. National Online Trading Limited

**Reading List**

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

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**DISCIPLINARY MATTERS**

The Australian Stock Exchange Limited's National Adjudicatory Tribunal ("The Tribunal") has determined the following:

**Reynolds & Co Pty Limited** ("Reynolds") has been fined \$70,000 (plus GST) by the National Adjudicatory Tribunal ("the Tribunal") with respect to a breach of ASX Business Rule 13.5.1 (and its predecessor Article 52 of the ASX Articles of Association) in the period from 26 October 1993 to 3 August 2001. The Tribunal has accepted the compliance undertakings offered by Reynolds, as set out below. Reynolds elected to refrain from contesting that the breach occurred.

The circumstances of this matter are as follows:

**Supervision**

The Tribunal found that Reynolds failed to adequately inquire into and investigate the activities of an adviser where there were factors that ought to have put it on inquiry in relation to the adviser's activities and that it failed to put in place and enforce adequate supervision and compliance systems with respect to the activities of that adviser.

In particular from at least March 2000 to 9 July 2001, when the advisor left Reynolds, Reynolds ought to have been put on inquiry regarding the possibility that an adviser was engaging in misconduct and should have inquired into and investigated that conduct for the following reasons:

- (a) a cheque for \$3,124.55 was drawn in favour of a client by Reynolds on 23 March 2000 against a client account that had a nil balance thereby placing the account into debit to the extent of \$3,124.55. The balance of \$3,124.55 was written off by Reynolds;
- (b) one of Reynolds' clients made a complaint in January 2001 which indicated among other things that he had been having trouble getting contract notes;
- (c) one of Reynolds' clients alleged that he had a discussion in June 2001 with a managing director of Reynolds in which he told that person that he had concerns with the adviser's activities and alleged that the adviser had executed trades without his instructions; and
- (d) on 4 July 2001 a bank cheque of \$23,196.25 was deposited into a client account operated at Reynolds and an amount of \$15,000 was paid to the client by Reynolds from the account. These payments do not appear to relate to any amount or transaction on the client's account and had the effect of placing the account into debit by \$1,150.04.

Reynolds failed to put in place and enforce adequate supervision and compliance systems and Reynolds' supervision and compliance systems were inadequate with respect to the adviser in the following respects:

- (a) advisers at Reynolds had access to contract notes within Reynolds' office and accordingly had the ability to intercept and prevent the despatch of contract notes by Reynolds to its clients;
- (b) Reynolds did not send itemised client account statements to clients unless they were requested by the client, or a cheque was drawn on the client's account, in circumstances where advisers had access to contract notes as described above;
- (c) Reynolds did not have an adequate system for ensuring that clients had authorised a change of address on their accounts or for keeping records of who had requested and/or authorised a change of address on a client account;
- (d) Reynolds did not ensure that its mail was opened and reviewed by its back office and that advisers did not have the ability to intercept and interfere with incoming mail;
- (e) Reynolds did not have an adequate system to prevent its advisers receiving client payments both in person and via the mail;
- (f) Reynolds did not have an adequate system to ensure third party cheques were correctly allocated;
- (g) Reynolds did not always obtain written authority from clients prior to setting up cash management accounts with third party providers on their behalf;
- (h) Reynolds did not obtain written authority from clients prior to transferring their cash management accounts from one provider to another provider;
- (i) Reynolds did not always obtain written authority from clients prior to transferring funds on their behalf between Reynolds' trust account and their cash management accounts at third party providers;
- (j) advisers had access to documents intended by Reynolds to be sent to clients in relation to their cash management accounts in circumstances where there were discrepancies on clients' cash management accounts;
- (k) an adviser at Reynolds was also responsible for the operation of clients' cash management accounts at a third party provider;
- (l) in the first instance, Reynolds allowed an adviser to respond to a complaint made by a client against the adviser without independently investigating the facts and evidence relating to the complaint;
- (m) two clients have alleged that they informed Reynolds of trading on their client accounts without or contrary to client instructions;
- (n) advisers had access to cheques drawn by Reynolds against clients' trading accounts and accordingly had the ability to intercept and misappropriate those cheques in circumstances where two cheques drawn by Reynolds against clients' trading accounts and payable to a Bank have been traced to an adviser's bank account; and
- (o) Reynolds did not have an adequate system of internal controls to track cheques once they were drawn against clients' trading accounts.

### **Withdrawals from Trust Account**

In the period from 26 October 1993 to 3 August 2001 Reynolds, on a number of occasions, made transfers from its trust account to cash management accounts operated by third party providers on behalf of its clients without first obtaining written authorisation from the client.

In the period from 29 April 1996 to 4 July 2001 Reynolds withdrew 5 payments from its trust account in circumstances where those payments had been allocated to the credit of the wrong client.

In the period from 3 October 1995 to 4 July 2001 Reynolds did not ensure it received funds for 8 purchases of securities and 5 subscriptions for securities on behalf of employees, directors or their immediate family or family companies at a time on or before it was required to settle the transactions.

### Compliance Undertakings

Reynolds irrevocably and unconditionally undertook to ASX that it:

- (1) would certify to ASX by 8 weeks after the Tribunal gave its decision in this matter, that it had implemented all of the matters referred to in Attachment A; and
- (2) agreed to be bound by the above undertakings and will not unreasonably challenge any action taken by ASX to enforce any or all of these undertakings.

### Attachment A

#### For Head Office and All branches:

#### Operational elements

Reynolds to provide to ASX, written Compliance Policies and Procedures which clearly demonstrate satisfaction of clause 3.2.1 of Australian Standard AS3806. Issues to be covered include:

- ⇒ All incoming mail to be opened centrally, with all cheques, payment instructions and detail amendments received being given directly to back office staff and all complaints to the complaints officer. Specific provisions to emphasise that there must be no interference from advisers or other front office staff in these issues;
- ⇒ Access to systems to be restricted so that no front office staff are able to amend client details or establish accounts in the back office system;
- ⇒ Identification and address verification for all new accounts to be conducted by back office staff and records of verification kept. (No client accounts to be opened using Reynolds' address);
- ⇒ No adviser (or front office staff member) to have access to any client's funds, either in Trust or in any Cash Management Trust Account (CMT) with a third party provider - any authorisation to access client funds must be given in writing to Reynolds not to individuals;
- ⇒ Original of all contract notes to be despatched by back office staff to clients. No original contract notes to be retained in the office. All staff to be advised that any requests by advisers to obtain or retain contract notes to be reported to senior Management;
- ⇒ Account statements to be sent to clients by back offices staff at least quarterly or more frequently if requested to do so by a client;
- ⇒ CMT statements to be sent to clients by back offices staff at least monthly or more frequently if requested by a client;
- ⇒ Funds received from clients to be allocated to client accounts by back office staff. Written policy and procedure to adequately cover circumstances where funds are received from a third party, by cheque or transfer from another account or a CMT account, including details of the authority from the drawer to use the funds for a third party;
- ⇒ Advisers not to be permitted to receive cheques or other payments from clients payable other than to Reynolds (or the limited circumstances in which payment to a third party is permitted, such as an IPO);

- ⇒ Payments to clients to be made and dispatched by back office staff without the possibility of interception by advisers or front office staff (not even for delivery or collection) either from Trust or CMT accounts. Any monies requested to be collected to be held by reception and signed for by the client;
- ⇒ Payments to third parties from Trust or CMT accounts to require appropriate written authorisation from client, with signature verification (recorded);
- ⇒ Specific policies and procedures governing the establishment and operation of CMT accounts;
- ⇒ Physical segregation of front and back office;
- ⇒ Regular but random reviews of client statements of account for unusual transactions, by way of review of a percentage of each adviser's clients;
- ⇒ Complaint handling procedures, including investigation of all complaints, that is independent of advisers and prevents interception of complaints by advisers or interference with Complaint Handling Procedures and reviews by advisers. Specific arrangements to be put in place to ensure that clients complaining by telephone are connected to the person they request to speak to (especially if that person is a director or the Complaints or Compliance Officer) without the possibility of diversion to an adviser;
- ⇒ Staff trading procedures and reviews – including ensuring that no credit is provided to staff and to ensure client order precedence;
- ⇒ Monthly reviews of order records for compliance with the requirements of the Business Rules;
- ⇒ Procedures for handling returned mail, especially cheques and contract notes, including contacting clients to verify address changes;
- ⇒ Procedure for processing journals, restriction to who may process such journals and what authorisation is required with specific provisions to ensure advisers do not access journal processing;
- ⇒ Policy and Procedure for handling errors – including authorisation requirements and verification that it is a genuine error and whether it is a “house” error or a client error and that it is allocated accordingly. Reports on allocations to errors account and frequency of allocations by each adviser to be provided to the Board monthly;
- ⇒ Policy and procedure regarding reconciliation of house, error and suspense accounts;
- ⇒ Market Misconduct policy and procedure including manipulation and insider trading;
- ⇒ Supervision of branch offices including written monthly reporting requirement from branch Managers and regular oral reporting. Periodic on-site reviews of branch offices. Specific procedure to ensure that no client funds are accessed by staff at branch offices (incoming and outgoing funds).

### **Compliance Resourcing:**

Reynolds to appoint a compliance officer or officers who are independent of senior management and the board. The compliance officer is to satisfy, or where there is more than one compliance officer, the compliance officers are to collectively satisfy, the requirements of clause 3.2.4 of AS3806. At a minimum, at least one of the compliance officers should be in attendance at Reynolds' offices during trading hours (10 am-4 pm) on each Business day.

### **Maintenance elements**

Reynolds to provide to ASX within 8 weeks from the date of the Tribunal's decision in this matter a supervisory plan and procedures document for the following 12 month period to ensure that these policies and procedures are being adhered to on a continual basis. The plan must clearly satisfy the monitoring and assessment element of AS3806 by demonstrating

that it is a strategy for continual monitoring setting out internal and external monitoring processes and outlining the schedule for the program, the resources required and the data to be collected. The plan must include predetermined, documented compliance objectives and assessment criteria. A further supervisory plan and procedures for a second 12 month period is to be prepared prior to the conclusion of the first 12 month period.

Adoption of an internal compliance recording process which satisfy the requirements of clause 3.3.5 of AS3806.

Adoption of a compliance reporting process which satisfies the requirements of clause 3.3.8 of AS3806.

## Reporting

Reynolds' Compliance Officer(s) is (are) to report to ASX (quarterly for 2 years commencing from the date of the Tribunal's decision in this matter) within 10 trading days of the end of each quarter the progress being made (in that persons opinion) by Reynolds in respect of giving effect to the compliance plan (supervisory plan and procedures). The report to attach copies of the following documents:

- ⇒ breach register and actions taken for the quarter;
- ⇒ Complaint register for the quarter;
- ⇒ Internal compliance committee minutes;
- ⇒ monthly reports to the Board of Reynolds comprising, progress against the compliance plan, compliance exposures identified, breaches identified and remedial actions taken;
- ⇒ extracts of the minutes of the Board of Reynolds setting out its consideration of all compliance issues that have arisen.

**Bridges Financial Services Pty Limited ("Bridges")** has been fined a total of \$5,000 (plus GST) in respect of:

1. a breach of Rule 1.2.1.2(b) (requirement to record the time of the receipt of instructions of a client) on 4 occasions during the period 6 August to 20 August 2002;
2. a breach of Rule 1.2.1.2(c) (requirement to record the name of the person placing instructions) on 16 occasions during the period 6 August to 20 August 2002; and
3. a breach of Rule 1.2.1.2(c) (requirement to record the name of the person by whom those instructions are received) on 4 occasions during the period 6 August to 20 August 2002.

The circumstances of the matter are as follows:

In October and November 2002, ASX Compliance and Information conducted on-site reviews of Bridges' business offices. As part of the review, ASX Compliance and Information sampled a total of 60 order records to determine if they complied with ASX Business Rule 1.2.1.2.

In conducting the review ASX Compliance and Information identified a number of order records which appeared to breach ASX Business rule 1.2.1.2(b) and (c).

In determining the penalty the Tribunal took into account the following matters:

- the breach was not self reported;
- out of the 60 orders sampled a high percentage of orders were in breach; and
- Bridges have undertaken a number of steps to ensure that it does not breach ASX Business Rule 1.2.1.2 in the future.

**Shaw Stockbroking Limited ("Shaw")** has been fined a total of \$15,000 (plus GST) in respect of:

1. a breach of Old Rule 5.6(2) (requirement to notify ASX in advance of the address at which a securities business is carried on) since 14 August 2000;
2. a breach of Old Rule 5.6(3) (requirement that each place at which a securities business is carried on be under the supervision and direct control of an affiliate, approved representative or responsible executive located in that office) in the period from 14 August 2000 to 15 July 2002 (the last day the Rule was in effect); and
3. a breach of Rule 5C.3.1(d) (requirement to ensure that a branch office is supervised as required under the Rules in existence prior to 16 July 2002) in the period from 16 July 2002 to 22 January 2003.

The circumstances of this matter are as follows:

An individual who was a proper authority holder ("the Relevant Person") of Shaw from 14 August 2000 to 22 January 2003 conducted activities on behalf of Shaw from the offices of another company.

The Relevant Person was ordinarily located at the other company's offices when he conducted activities on behalf of Shaw.

Shaw has advised ASX that there is no relationship between itself and the other company. Shaw understood that the other company had issued a Proper Authority to the Relevant Person, however in fact this did not occur until 2 August 2002.

On a daily basis the Relevant Person took orders from clients to purchase and sell ASX listed securities and arranged for the orders to be executed under the proper authority granted to him by Shaw. The Relevant Person's orders mainly came from institutional clients. Substantial orders (both in number and value) were executed by Shaw as a result.

Shaw has advised ASX that the Relevant Person's clients primarily trade in ASX Top 200 securities and securities that are related to transactions in which the other company was the underwriter or financial adviser.

Various people at Shaw reviewed individual aspects of the Relevant Person's trading. None of the people detailed are located at the premises occupied by the Relevant Person and none of the persons named, with the exception of the Managing Director of Shaw, were affiliates, approved representatives or responsible executives of Shaw.

In determining the penalty the Tribunal took into account the following matters:

- The Relevant Person undertook a significant amount of business on behalf of Shaw;
- The Relevant Person was located in the offices of an organisation (the other company) that may, at various times, have had access to non public information;
- Shaw was not aware of what activities the Relevant Person undertook on behalf of the other company and what information he had access to;
- ASX Business Rule 5.6(3) is an important Rule which is both well understood and is fundamental to the operation of branch offices. In this regard a Guidance Note was issued on 26 May 1995 (GN1/95) regarding the operation of Rule 5.6(3)(prior to the inclusion of Responsible Executives within the Rules); and
- The failure to notify ASX that Shaw was conducting a securities business from the other company's offices prevented ASX from raising any concerns it may have had with such an arrangement with Shaw prior to the arrangement coming into effect.

**National Online Trading Limited ("National Online")** has been fined a total of \$10,000 (plus GST) in respect of a breach of Rule 1.2.2(4) during the period 23 August 2000 to 16 September 2002 in that client funds were withdrawn from its Trust Account in circumstances where National Online was not entitled to do so.

The circumstances of this matter are as follows:

National Online's procedures for the operation of its Trust Account assumed that, after transferring the requisite funds from its Trust Account to its clients' bank accounts, any amounts remaining would relate to brokerage fees and funds relating to GST liability. Such funds would be funds that National Online would be entitled to withdraw from its Trust Account under Rule 1.2.2(4). Accordingly at the end of the each trading day National Online would automatically transfer the balance of the Trust Account to its Operating Bank Account (a non-trust account), and would reconcile its Trust Account to a nil balance each day.

As a result of an internal review of National Online's back office systems carried out in September 2002 National Online became aware that on 122 occasions client funds held in its Trust Account had, without authority, been transferred by National Online to a non-Trust Account.

The unauthorised withdrawal of client funds primarily occurred because of some of National Online's clients had provided incorrect banking details which caused the transfer of funds to the client to fail. The result being that at the end of the day these client funds would be treated as funds which National Online were entitled to withdraw.

A total of \$1,114,119 in client funds was incorrectly transferred to a non-trust Account by way of a total of 122 unauthorised withdrawals which resulted in interest of \$592.67 being received by National Online.

In all instances National Online corrected the unauthorised withdrawals. Upon discovering that its bank had rejected an attempted transfer of client funds National Online would either contact its bank to verify incorrect account details, or would contact the client directly to confirm the correct account details. National Online would then transfer these funds from its non-Trust Account to the client's bank account. Most of these unauthorised withdrawals were corrected within 1-2 business days. On the occasions that further delay occurred this was due to delays caused by the relevant customers failing to provide correct details, however, during this time interest was not earned on the amounts.

In determining the penalty the Tribunal took into account the following matters:

- National Online self reported the breach;
- ASX Business Rules 1.2.2(4) is an important client asset protection mechanism;
- National Online ought reasonably to have been aware that each time the attempted transfer of client funds was rejected by its bank, that due to the procedures it employed these client funds would remain in its Trust Account and would subsequently be transferred to a non-Trust Account; and
- The withdrawal of client funds continued for a considerable period of time – more than 2 years from 23 August 2000 to 16 September 2002.