



ASX Circular

Date: 16 June 2004

Key topics

1. Shadforths Limited
2. A.C.N. 008 082 157 Pty Limited
3. National Online Trading Limited
4. Macquarie Equities Limited
5. Ord Minnett Limited

Reading List

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

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No responsibility is accepted for any inaccuracies contained in the matter published.

DISCIPLINARY MATTERS

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

Shadforths Limited ("Shadforths") has been fined \$10,000 plus GST by the Tribunal with respect to breaches of old ASX Business Rules 1A2.1(1)(a) and 1A2.2(1)(b) during the period 4 to 7 March 2003 and breaches of these Rules during the period 27 to 31 March 2003.

The circumstances of this matter are as follows:

Breaches during the period 4 to 7 March 2003

On 4 March 2003, Shadforths' executed a relatively large buy order on behalf of a client. At the time Shadforths' had insufficient Liquid Capital such that it could execute the order and continue to comply with old ASX Business Rule 1A. In this regard, Shadforths requested that the client provide funds to settle the trade by way of electronic funds transfer. As a result of a number of circumstances the funds were not received until 6 March 2003 thereby causing Shadforths to breach old ASX Business Rule 1A2.1(1)(a) during the period 4 to 6 March 2003.

Under old ASX Business Rule 1A.2.2(1)(b) Shadforths was required to notify ASX promptly and in writing when the value of a Liquid Capital ratio described under old ASX Business Rule 1A fell below a specified level. The effect of the execution of the order referred to above was that the ratio fell below the specified level on 4 March 2003. Shadforths did not notify ASX of this fact until 7 March 2003, contrary to ASX Business Rule 1A2.2(1)(b).

Breaches during the period 27 to 31 March 2003

On 27 March 2003, Shadforths received an order from the same client to sell the same volume of securities that had been purchased on 6 March 2003. At the time Shadforths had insufficient Liquid Capital such that it could execute the order and continue to comply with old ASX Business Rule 1A. Shadforths executed the order on 27 and 28 March 2003. The effect of the execution of the order was to increase Shadforths' Counterparty Risk Requirement under old ASX Business Rule 1A. Shadforths could have reduced its Counterparty risk Requirement (and thereby continued to comply with old ASX Business Rule 1A) by transferring the securities to be sold to its Entrepot Settlement Account prior to the execution of the order. Due to a misunderstanding on behalf of Shadforths' back office staff this did not occur and accordingly Shadforths breached old ASX Business Rule 1A2.1(1)(a).

Under old ASX Business Rule 1A.2.2(1)(b) Shadforths was required to notify ASX promptly and in writing when the value of a Liquid Capital ratio described under old ASX Business Rule 1A fell below a specified level. The effect of the execution of the sell order referred to above was that the ratio fell below the specified level on 27 March 2003.

Shadforth's did not notify ASX of this fact until 30 March 2003 contrary to ASX Business Rule 1A2.2(1)(b). Shadforth's failure to comply with old Rule 1A.2.2(1)(b) apparently occurred because of mistaken belief on behalf of Shadforth's management that the securities to be sold had been transferred to Shadforth's Entrepot Settlement Account.

With respect to the breaches that arose during the period 4 to 7 March 2003, the Tribunal imposed a penalty of \$4,000 plus GST and with respect to the breaches that arose during the period 27 to 31 March 2003, the Tribunal imposed a penalty of \$6,000 plus GST. In this regard, the Tribunal was of the view that after the breaches which occurred during the period 4 to 7 March 2003, Shadforth's was put on notice that it should review its systems. Its failure to do this in the least contributed to the breaches which occurred in the period 27 March to 31 March, and accordingly, the penalty for the breaches during this period was higher.

A.C.N. 008 082 157 Pty Limited (formerly known as Terrain Securities) ("Terrain") has been fined \$150,000 plus GST by the Tribunal with respect to breaches of ASX Business Rules 3.4.1(1), 3.4.4, 1.2.1.2, 1.2.1.4, old rule 3.8(1), 7.3.1B.1 and in respect of Prohibited Conduct.

There was no appearance by either party at the hearing and no argument in mitigation advanced for or on behalf of Terrain. The Tribunal formed the view that the breaches had been made out on the basis of the facts outlined in the Final Inspection Report forwarded to the Tribunal by ASX's Investigation and Enforcement Department.

The circumstances of this matter are as follows:

Charge 1

Terrain breached ASX Business Rule 3.4.1(1) on two occasions, in that between 8 April and 10 October 2002 ("Relevant Period") Terrain managed or operated two discretionary accounts for or on behalf of clients without first having obtained from each of those clients a written authorisation signed by the respective client setting out the terms and conditions under which Terrain was to operate each of the discretionary accounts.

Charge 2

A breach of ASX Business Rule 3.4.4 on two occasions, in that during the Relevant Period Terrain failed to include any details of two discretionary accounts operated by it, on a Register as required by Rule 3.4.4.

Charge 3

A breach of ASX Business Rule 1.2.1.2 on 101 occasions in that during the Relevant Period, Terrain failed to maintain accurate records in sufficient detail showing particulars of the name of the person placing the instructions. The order records incorrectly stated that the client had placed the order when in fact it was the adviser who initiated the orders.

Charge 4

A breach of ASX Business Rule 1.2.1.4 on four occasions during the Relevant Period, in that Terrain failed to maintain records referred to in Rule 1.2.1.2 in respect of transactions conducted by it on behalf of clients. When requested, Terrain was unable to produce order records in respect of the transactions.

Charge 5

A breach of ASX Business Rule 3.8(1) on 23 occasions between 8 April and 24 June 2002 in that Terrain failed to immediately despatch to a client a contract note in respect of the purchase or sale of each security executed for and on account of that client. Instead the contract notes were accumulated and sent weekly or fortnightly to the client.

Charge 6

A breach of ASX Business Rule 7.3.1B.1 on four occasions in that Terrain failed to ensure that the employee who provided advice to four clients in relation to a derivatives product, complied with the accreditation requirements set out in Rule 7.3.1B.

Charge 7

During the Relevant Period, Terrain engaged in Prohibited Conduct as referred to in old ASX Business Rule 1.5.1 and as defined at the time in the Business Rules, with respect to its dealings, and supervision of those dealings, with certain clients in a manner that:-

- (i) was unsatisfactory professional conduct, involving a substantial or consistent failure to reach reasonable standards of competence and diligence, and/or
- (ii) amounted to conduct which is or could reasonably be considered to be prejudicial to the interests of the Exchange or its Participating Organisations or Affiliates

in that amongst other things, Terrain:

- (iii) failed to adequately supervise the employee responsible for the discretionary account trading;
- (iv) failed to adequately investigate the manner in which client accounts were being operated;
- (v) when Terrain became aware that an account was being operated as a discretionary account, it took no action to obtain the correct documentation or include details of the discretionary account on the Discretionary Account Register; and
- (vi) permitted a client adviser to operate an options account when he was not an accredited derivatives advisor.

In relation to:

Charge 1 - the Tribunal imposed a penalty of \$30,000 plus GST;

Charge 2 - the Tribunal imposed a penalty of \$10,000 plus GST;

Charge 3 - the Tribunal imposed a penalty of \$10,000 plus GST;

Charge 4 - the Tribunal imposed a penalty of \$15,000 plus GST. When considering the penalty to be imposed for a breach of this rule, the Tribunal considered that this rule was an important rule and that the penalty should reflect the importance of the rule.

Charge 5 - the Tribunal imposed a penalty of \$15,000 plus GST;

Charge 6 - the Tribunal imposed a penalty of \$40,000 plus GST. The Tribunal was of the opinion that the rule relating to the accreditation requirements was important given the nature of the security and the fact that it was common for clients to not understand derivatives products. It was agreed that the penalty for this breach should be high.

Charge 7 - the Tribunal imposed a penalty of \$30,000 plus GST. The Tribunal was of the view that ordinarily a compliance undertaking would be included in the mix of penalties for this kind of breach, but that given that Terrain was in administration, a compliance undertaking in this case was not appropriate and that accordingly, the pecuniary penalty should be higher than it might otherwise be.

National Online Trading Limited ("NOLT") has been fined \$60,000 (plus GST) by the Disciplinary Tribunal ("**Tribunal**") with respect to breaches of ASX Business Rules 1.2.2(4) and 1.5.2(1) during the period 14 November 2001 to 27 February 2003 ("**Relevant Period**") in that client funds were withdrawn from its Trust Account in circumstances where NOLT was not entitled to do so. NOLT elected not to contest the Charges in respect of each breach.

The circumstances of this matter are as follows:

ASX Business Rule 1.2.2(4)

During the Relevant Period NOLT operated several independent trust accounts. the circumstances of this matter are only concerned with the operation of one of these trust accounts ("**Trust Account**").

A systems failure resulted in the overstatement of the cash position of certain client monies in the Trust Account and enabled monies to be withdrawn on behalf of clients from the Trust Account to which those clients were not entitled. Withdrawals in excess of available client funds occurred in circumstances where a client would request a direct credit transfer of funds from

their NOLT trading account to their bank account. NOLT would then instruct its bank to debit the Trust Account with the relevant amount. Following the physical transfer of funds from the Trust Account to the client's personal bank account, NOLT's trust account procedures required the accounting system to update the available balance of the client's trading account. However, the accounting system failed to update the trading account balance of certain clients that had requested a direct credit transfer of funds, enabling them to request payment of funds from the Trust Account in excess of what each client was entitled to be paid.

During the Relevant Period, a total of \$204,525.76 in client funds was incorrectly withdrawn from NOLT's trust account by way of 43 unauthorised withdrawals.

In late February 2003, a client of NOLT's advised it of an error with respect to their NOLT trading account and soon after the systems error was discovered. To correct the systems error, NOLT promptly transferred a total of \$186,796 into the trust account, and took other remedial action.

ASX Business Rule 1.5.2(1)

Taking into account the breach of ASX Business Rule 1.2.2(4) by NOLT, as a consequence of it not holding the correct amount of client monies in its trust account NOLT did not correctly reconcile the balance in the Trust Account to its accounting records during the Relevant Period in breach of ASX Business Rule 1.5.2(1). Whilst reconciliations of the Trust Account occurred during the Relevant Period, the reconciliations were ineffective because they did not examine the movement of funds down to the level of each client involved.

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

- NOLT had self reported the breaches;
- NOLT had fully acknowledged that ASX Business Rule 1.2.2(4) is an important client asset protection mechanism;
- Although the unauthorised withdrawal of client funds stemming from the latent systems error continued for 16 months during the Relevant Period, NOLT had taken prompt and effective action to remedy the situation and rectify the systems error (including the deposit of funds to cover the withdrawals);
- NOLT had engaged internal and external consultants in 2003 to conduct a review of its trust accounting systems and procedures to ensure there would be no recurrence of the error, which have since confirmed the system and procedures are effective;
- There was no loss to any NOLT clients;
- NOLT had gained no commercial or financial advantage as a result of the breaches, and
- Although this was the second time that NOLT had contravened trust account Business Rules (in June 2003 NAT imposed a fine on NOLT of \$10,000 (plus GST) with respect to a breach of ASX Business Rule 1.2.2(4)), the circumstances of that breach differed from the circumstances of the current breach.

Macquarie Equities Limited ("MEL") has been fined the sum of \$25,000 plus GST:

- (i) in respect of the conduct which occurred on 29 October and 21 November 2002 with respect to breaches of ASX Business Rules 1.2.1.2, 1.2.1.3(a) and 7.3.2.5, - the sum of \$7,500.00 plus GST; and

- (ii) in respect of the conduct which occurred on 27 May 2003 with respect to breaches of ASX Business Rules 1.2.1.2 and 7.3.2.5 - the sum of \$17,500.00 plus GST. This penalty was higher than the penalties arising from the breaches in (i) as a result of MEL's failure to rectify the deficiencies which gave rise to the breaches on 29 October and 21 November.

The Tribunal has accepted the voluntary undertakings offered by MEL as set out below. MEL did not contest the breaches before the Tribunal.

The circumstances of this matter are as follows:

ASX Business Rule 1.2.1.2

On 29 October 2002 on 61 occasions, on 21 November 2002 on 44 occasions and on 27 May 2003 on 46 occasions, MEL failed to maintain accurate records showing particulars of:-

- (a) instructions by clients to purchase or sell Securities (including, without limitation, the name of the client, the number of the Securities to be bought or sold, any price or time related instructions and any time limit on the order and identification of the Securities);
- (b) the date and time of the receipt by the Participating Organisation of instructions of a client, and/or
- (c) the name of the person placing the instructions and of the person by whom those instructions were received.

ASX Business Rule 1.2.1.3(a)

On 29 October 2002 on 10 occasions and on 21 November 2002 on 22 occasions, MEL failed to ensure that the orders referred to in ASX Business Rule 1.2.1.2 were made immediately after the order or decision was placed or made, or amended and that the time of the relevant action was recorded.

ASX Business Rule 7.3.2.5

On 29 October 2002 on 17 occasions, on 21 November on 18 occasions and on 27 May 2003 on 4 occasions, MEL failed to maintain accurate records showing particulars of:-

- (a) instructions by clients to enter into an Option Transaction (including, without limitation, the name of the client and the person placing the order, identification of and the number of Options to be written or taken, price related instructions and any time limit on the order) whether executed or not, and/or
- (b) the date and times of the receipt by the Participant of instructions of a client, their communication to a Designated Trading Representative by whom they are executed.

Enhancement of Compliance Practices and Systems

Since ASX raised its initial concerns in December 2002 MEL has taken the following action to address those concerns -

1. Structural Change
 - New employment contracts linking compliance behaviours to remuneration.
 - Development and Implementation of a Risk Management Framework.
 - Increased headcount in Risk Management and Compliance resulting in the creation of Compliance positions in regional offices.
 - Development and implementation of an order routing system with particular focus on compliance with the ASX order taking requirements.
2. Increase in surveillance
 - Introduction since the beginning of 2003 of an Order Record Review Program providing for systematic reviews of advisers order records.
 - Introduction of penalties for non-compliant behaviours.
3. Increase in education/awareness

Voluntary Undertaking

In addition to the Proposed Outcome, MEL volunteered the following undertaking to ASX:-

MEL irrevocably and unconditionally undertakes that the compliance programme that it has in place in respect of Trading Records shall be amended to include requirements that from 1 July 2004 to 30 June 2006:-

- (a) at a frequency of not less than once per month, MEL shall conduct random spot checks of the Trading Records created by a representative sample of its dealers located in Australia, and
- (b) the MEL Board of Directors shall be provided with a written report ("**Report**") (within 10 trading days of the end of each quarterly period) which identifies the nature, extent and circumstances of any non-compliance with the ASX's Market Rules concerning Trading Records disclosed by the random spot checks undertaken during that quarter, and which also identifies the action taken or to be taken (if any) in respect of such non-compliance.

MEL further undertakes to ASX to supply to ASX Compliance Services:-

1. a copy of the Report within 5 Business Days of it being provided to MEL's Board of Directors , and
2. a copy of MEL's Board minutes pertaining to the Report within 5 Business Days of the respective Board minutes being ratified.

The failure by ASX to take action in respect of any matter or thing which may indicate a breach of ASX's Business Rules and which is contained in the Report shall not be construed as either a waiver of ASX's right to take action or an acceptance of the matter or thing, by ASX.

Ord Minnett Limited ("**Ord Minnett**") has been fined \$100,000.00 (plus GST) by the Disciplinary Tribunal ("**Tribunal**") with respect to breaches of old ASX Business Rules 13.5.1, 7.3.1.1(b) and 7.3.1.3 arising from its conduct during the period between 8 January 1998 to 24 March 2003 inclusive ("**Relevant Period**"). The Tribunal has accepted the voluntary undertakings offered by Ord Minnett, as set out below. Ord Minnett, without making any admission of breach, elected to refrain from contesting the breaches before the Tribunal.

The circumstances of this matter are as follows:

Old ASX Business Rule 13.5.1

During the relevant period Ord Minnett failed to adequately supervise an advisor ("**Relevant Advisor**") and 133 client accounts ("**Accounts**") that traded through the Relevant Advisor.

Characteristics of the Accounts, and/or the manner in which they were operated, included the following:-

- the Accounts predominantly traded in exchange traded options;
- the clients on whose behalf the Accounts were operated ("**Clients**") all entered into client agreements with Ord Minnett ("**Client Agreements**") and did so by signing Ord Minnett client forms provided to them by a third party ("**Third Party**");
- the Clients were trading through the Third Party to whom they granted a discretion to make trading decisions and to receive information on their behalf;
- the Clients nominated the Third Party as the person to receive all of the reporting documents regarding trading from Ord Minnett;
- the Third Party was not within the control or under the supervision of Ord Minnett;
- until October 2001, the Third Party did not have a securities dealer's licence or a proper authority from a licensed securities dealer;

- the Relevant Advisor and some of the management within Ord Minnett appeared to treat the Third Party as Ord Minnett's client rather than treating the Clients as being Ord Minnett's clients;
- the Client Agreements signed by the Clients included warnings from Ord Minnett regarding the risks of options trading generally;
- the Clients appear to have received the ASX Options Booklet;
- upon completing the Client Agreements, most of the Clients elected not to provide Ord Minnett with any information regarding their respective financial situations and investment objectives;
- at all relevant times Ord Minnett informed the Third Party, rather than the Clients, of the trades executed on the Third Party's instructions and on behalf of the Clients, as instructed by the Clients;
- members of Ord Minnett's management did not inform themselves as to whether or not the Relevant Advisor was providing advice to the Clients (which did happen through the Third Party on some occasions) or was providing execution only services;
- while there was regular communication between the Relevant Advisor and the Third Party, the advice that was provided by the Relevant Advisor was provided in circumstances where Ord Minnett and the Relevant Advisor had very little direct contact with the Clients, and
- other than the explanation included in the Client Agreements, Ord Minnett did not explain to the Clients, and was unaware of the extent to which any such explanation had been given to the Clients by the Third Party (or by anyone at all) regarding the trading occurring on the Accounts, the risks of options trading generally or the risks of particular strategies that had been adopted on the instructions of the Third Party.

As a result of the above it was possible that the Clients would (and did) suffer significant trading losses without the Clients being fully aware of, or understanding, the trading occurring and the positions taken on the Accounts.

Further, during part of the Relevant Period the Accounts exhibited a number of features ("**Features**") that ought to have alerted the Relevant Advisor and management of Ord Minnett to the possibility that some or all of the Clients may not have been aware of, or understood, some or all of the trading and positions on their respective Accounts or may not have had the financial capacity to support such trading and positions. The Relevant Advisor and Ord Minnett's Options Manager, were aware of the Features, which included:-

1. third party collateral being provided by the Third Party and entities related thereto, against some of the Accounts on 327 occasions during 24 June 2002 to 20 March 2003;
2. the level of debt for some of the Clients in respect of their failure to meet OCH margins, was such that they may have been prevented from trading in accordance with Ord Minnett's options credit policy, on at least 7 days between 15 May 2002 and 17 March 2003;
3. a number of the Clients were in breach of Ord Minnett's margin limit requirements, on at least 6 days between 14 September 2002 and 15 March 2003, and
4. the pattern of trading on the Accounts.

This arose from a possible failure by the Third Party agent to communicate to the Clients information regarding the Third Party's trading decisions and information received by the Third Party from Ord Minnett concerning the trading conducted on behalf of the Clients.

The omission by Ord Minnett, from the dates that the Features became apparent until Ord Minnett took action in March 2003, to become alerted to the possibility that some or all of the Clients may not have been aware of, or understood, some or all of the trading and positions on their respective accounts or may not have had the financial capacity to support such trading and positions and to take appropriate action, constituted a failure to supervise the Relevant Advisor and the Accounts and accordingly a failure to reach reasonable standards of competence and diligence.

Ord Minnett first took steps on or about 25 March 2003 to contact the Clients directly to check whether they were aware of the losses being occurred on the Accounts and on 26 March 2003 first notified ASX (and ASIC) in writing of its concerns that reports from Ord Minnett to the Third Party regarding trading conducted on the Accounts might not in all cases have been communicated by the Third Party to the Clients.

Old ASX Business Rule 7.3.1.1(b)

As Ord Minnett was unable to locate signed risk disclosure statements in respect of 4 of the Clients, the Tribunal accepted that during the Relevant Period Ord Minnett had failed to ensure that each of those Clients had signed a risk disclosure declaration prior to, or at the time of, the first order being accepted from each of those Clients.

Old ASX Business Rule 7.3.1.3

As Ord Minnett was unable to locate signed ASX Derivatives Agreements for 2 of the Clients, the Tribunal accepted that during the relevant Period Ord Minnett had failed to ensure that it retained a copy of the client agreements complying with ASX Business Rule 7.3.1.2 and setting out the terms and conditions governing the relationship between Ord Minnett and the respective Clients, in respect of options transactions.

Ord Minnett's Co-operation With ASX

The Tribunal took into account the co-operation and assistance provided by Ord Minnett to ASX during the course of this investigation and the pro-active manner in which Ord Minnett raised this matter with ASX.

Voluntary Undertakings

Ord Minnett irrevocably and unconditionally undertook to ASX that, commencing 30 September 2004 and thereafter on a quarterly basis until 30 June 2006 inclusive, the Chief Operating Officer and the Manager of Compliance will together provide ASX with a written report (within 10 trading days of the end of each quarterly period) stating whether, in their opinion:-

1. the procedures adopted by Ord Minnett in respect of the risk management of its derivatives business were fully implemented and complied with during the period and, if not, the nature, extent and circumstances of any breaches together with the action taken (if any) in respect of such breaches, and
2. the procedures continue to remain adequate and appropriate for the management of risk in respect of Ord Minnett's derivatives business, and if not, whether Ord Minnett has updated (or will update) the procedures in order to enhance their adequacy and appropriateness, and if so, the nature of, and the reasons for, the changes made or to be made.

For the purposes of this Undertaking, a reference to Ord Minnett's procedures includes the written procedures and systems put in place by Ord Minnett, and as detailed by Ord Minnett to ASX during the course of its investigation, which includes:-

3. the adequacy of collateral;
4. the use of 3rd party collateral against client accounts;
5. margin limit policies, and
6. other such measures designed to ensure Ord Minnett's compliance with the obligations contained in the ASX rules and procedures governing the conduct of derivatives business.