



ASX Circular

Date: 22 September 2004

Key topics

1. Mortimer & Chua Pty Ltd
2. Credit Suisse First Boston Australia Equities Limited
3. Tricom Equities 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 Disciplinary Tribunal (**"the Tribunal"**) has determined the following:

Mortimer and Chua Pty Ltd ("Mortimer and Chua") has been fined \$75,000 (plus GST) under old Business Rule 13.5.1 in respect of its conduct in relation to two discretionary accounts managed on behalf of a client (the "client"). Mortimer and Chua on a non-admission basis, elected not to contest the merits of the charge before the Tribunal.

The circumstances of this matter are as follows:

Between 19 March 2001 and 5 April 2002 (the "relevant period"), Mortimer and Chua's Melbourne office securities representative ("the representative") operated two discretionary accounts on behalf of the client after the client had contacted the representative with a view to investing in the share market. The first account was used for transactions conducted until 22 October 2001, and the second account thereafter. Mortimer and Chua sold its Melbourne business at the close of business on 5 April 2002.

Contrary to ASX Business Rule 3.4.1(1), prior to operating the discretionary accounts, Mortimer and Chua failed to obtain any signed written authorisation from the client to operate a discretionary account. Contrary to ASX Business Rule 3.4.4, Mortimer and Chua also failed to maintain information relating to the discretionary accounts in a Register.

During the relevant period 490 transactions occurred on the client's accounts with all but two transactions having been conducted at the discretion of the representative. In respect of these transactions the representative filled out order records stating he had received instructions to buy and sell securities from the client by telephone, and had read the order back to the client when he had in fact placed each order at his discretion. Therefore, contrary to old ASX Business Rule 1.2.1(ii) (with respect to 184 securities transactions conducted on the client's accounts between 19 March 2001 and 23 August 2001, the day on which this old Business Rule was replaced by ASX Business Rule 1.2.1.2) and ASX Business Rule 1.2.1.2 (with respect to 304 transactions conducted on the client's accounts between 24 August 2001 and 3 April 2002), Mortimer and Chua failed to maintain accurate records of orders in sufficient detail which show the particulars of orders as required by ASX Business Rule 1.2.1.2, and formerly old ASX Business Rule 1.2.1(ii).

The representative sent the client monthly reports referring to activity on the accounts in the period from April 2001 to August 2001 under Mortimer and Chua letter head, and thereafter periodically Mortimer and Chua 'With Compliments' slips containing brief handwritten notes about the trading activity on the client's accounts. On or about 26 September 2001 at the request of the client, the representative and Mortimer and Chua's Melbourne office manager started to withhold contract notes from immediate despatch, and instead sent the contract notes periodically in conjunction with the 'With Compliments' slips. In doing so, Mortimer and Chua breached old ASX Business Rule 3.8(1) between 26 September 2001 and 3 April 2002.

Mortimer and Chua's Melbourne office Approved Representative (the "Approved Representative") apparently read the April 2001 monthly activity report before the report was sent to the client. This report clearly indicated the representative was trading the client's account on a discretionary basis. The Approved Representative was aware contract notes were not being immediately despatched to the client, and at one stage queried the representative and office manager as to whether the client's account was discretionary and asked them to get the appropriate documentation in place if this was the case.

The Tribunal determined that:

- (i) Mortimer and Chua breached the Business Rules referred to above;
- (ii) the Approved Representative and Mortimer and Chua's Melbourne office manager were aware or ought to have been aware Mortimer and Chua were breaching the Business Rules referred to above, and effectively sanctioned continuing breaches by failing to take adequate or appropriate action to correct the representative's behaviour; and
- (iii) because of (ii) above, Mortimer and Chua failed to exercise adequate supervision over the representative.

The Tribunal noted the client apparently authorised the representative to trade on a discretionary basis but the absence of a written agreement setting out the terms and conditions under which Mortimer and Chua were to operate the discretionary account on behalf of the client make it difficult to examine and assess whether the representative's activity was appropriate and in the best interests of the client.

In determining the appropriate penalty the Tribunal took into account that:

- ASX rules about Discretionary accounts and immediately sending contract notes (now confirmations) are aimed at protecting the interests of ASX Trading Participant's and their clients.
- Mortimer and Chua's client did not make any complaint about dealings on the client's accounts until 25 November 2002.
- During the relevant period Mortimer and Chua had in place and had supplied to the representative, a compliance manual and training manual which both dealt with the obligations to immediately send a contract note and the requirement for a written authorisation for a discretionary account.
- Mortimer and Chua at the earliest possible opportunity indicated it proposed not to contest the charge before the Tribunal.
- Mortimer and Chua has been an inactive ASX Participant Organisation since 5 April 2002, and is seeking to resign its recognition as an ASX Participating Organisation.

Credit Suisse First Boston Australia Equities Limited ("CSFB") has been fined a total of \$120,000 (plus GST) by the Tribunal in relation to breaches of ASX Business Rules 2.2.2(4)(a) and 2.2.2(1)(b)(i). The breaches were not contested by CSFB.

The circumstances of this matter are as follows:

ASX Business Rule 2.2.2(4)(a)

Prior to March 2001 and until 5 December 2002 CSFB operated 4 systems for the purpose of conducting Automated Order Processing ("**AOP**"). Prior to using these AOP systems, CSFB failed to provide to the Exchange any certification, as it was required to do in order to comply with Rule 2.2.2. Of the 4 systems 1 system (**System 1**) was operated for the purpose of conducting both Automated Client Order Processing ("**ACOP**") and Automated Principal Order Processing ("**APOP**") and 3 systems (**System 2**, **System 3** and **System 4**) were operated for the purpose of conducting APOP only.

In respect of System 1, CSFB had obtained certification by a qualified external person as required by the Rules, but had not provided a copy of the certification to ASX.

On and from 6 December 2002 the rules relating to AOP were changed to permit self-certification by a Participant in lieu of certification by an external person.

Between 6 December 2002 and 29 July 2003 CSFB operated 5 systems for the purpose of AOP of which 1 system (**System 5**) was operated exclusively for the purpose of conducting ACOP and 4 systems (**System 2**, **System 3**, **System 4** and **System 6**) were operated for the purpose of conducting APOP only. Prior to using these AOP systems, CSFB failed to provide to the Exchange certification (in the form prescribed by the Exchange), as it was required to do in order to comply with Rule 2.2.2.

CSFB operated each of the 6 AOP systems for the following approximate durations in breach of the Rules:-

- System 1 at least 6 months;
- System 2 3 years and 3 months;
- System 3 3 years;
- System 4 2 years and 7 months;
- System 5 4 months; and
- System 6 5 months.

ASX Business Rule 2.2.2(1)(b)(i)

On 29 July 2003 CSFB, as principal, entered into SEATS by way of AOP (**System 3**) the following Trading Messages in the following circumstances;

1. at 10:08:11, an Ask to sell 18,000 News Corporation Limited preference shares ("**NCPDP**") at 65c per share when, at the time, the market spread was Bid \$9.90/9.93 Offer;
2. at 10:08:22, an Ask to sell 192,000 NCPDP at 65c per share when, at the time, the market spread was Bid \$9.89/9.91 Offer; and
3. between 10:08:11 and 10:08:27, 42 Bids to buy between 8 and 1,352 News Corporation Limited ordinary shares at prices between \$164.34 and \$179.18 per share when, at the time of entering the first of these Bids, the last sale price was \$11.71 per share.

CSFB did not intend to submit these Trading Messages into SEATS at these prices. The prices resulted from an error and the messages were released into SEATS when the price filter failed as a result of a fault in the relevant software used with respect to System 3 and an error in CSFB's testing methodology. On 1 August 2003, CSFB certified system 3. The Tribunal found that CSFB failed to ensure that Trading Messages it submitted into SEATS did not interfere with the efficiency and integrity of the markets provided by the Exchange, thereby contravening Rule 2.2.2(1)(b)(i).

In assessing the seriousness of the breaches and the appropriate penalty to apply, the Tribunal took into account the following;

- ASX had become aware that CSFB was operating an AOP system without first having provided certification as required by the Business Rules from its response to the "Trading Best-Awareness and Self-Assessment Program" and that other uncertified AOP systems were in operation as a result of an subsequent onsite review conducted by ASX of CSFB's operations in early July 2003;

- CSFB operated its AOP systems (prior to July 2003) in contravention of the Rules because it was of the mistaken view that the certification it had obtained in respect of **System 1** was adequate for the purposes of compliance with Rule 2.2.2;
- upon being notified by ASX in early July 2003, that its interpretation of the Rules was incorrect, CSFB continued to operate 5 of the AOP systems although they were uncertified, whilst it attended to certification of those systems to ASX. CSFB unilaterally informed ASX of its progress in meeting its timetable for providing certification;
- CSFB acknowledged that its interpretation of the Rules was incorrect. Between 1 August and 8 October 2003, CSFB obtained and provided certification of systems 3-6 to the Exchange in accordance with the requirements of 2.2.2(4)(a);
- With respect to the trades that occurred as a result of the entry of Trading Messages in SEATS on 29 July 03, the Tribunal had regard to the fact that CSFB made efforts to have those trades cancelled and that others involved in these transactions did not incur financial loss; and
- CSFB elected not to contest the breaches.

Tricom Equities Limited ("Tricom") has been fined a total of \$10,000 plus GST in respect of a breach of ASX Business Rule 1A.2.6(1) in that Tricom entered into and gave a cross guarantee.

The Tribunal found that ASX Business Rule 1A.2.6(1) imposed a strict mandatory requirement that a participating organisation must not give a cross guarantee.

The document in issue in this matter was a bank document titled "*Cross Guarantee and Indemnity*". The Tribunal determined that the document was a cross guarantee and that the overall effect of the arrangement entered into by Tricom with other parties was to ensure that the indebtedness of each of the parties under the facility was guaranteed by each of the guarantors other than itself.

The Tribunal viewed the breach as reasonably serious with regard to the potential impact and exposure to financial risk from entities which were not regulated by the ASX, and over which the ASX was unable to exercise prudential supervision.