



ASX Circular

Date: 4 January 2012

Key topics

1. Commonwealth Securities Limited

Reading List

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

Contact

Cigdem Kocak

Telephone

(02) 9227 0112
 ASX Limited
 ABN 98 008 624 691
 Exchange Centre
 20 Bridge Street
 Sydney NSW 2000
 PO Box H224
 Australia Square NSW 1215

Internet: <http://www.asx.com.au>

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

DISCIPLINARY MATTERS

The ASX Disciplinary Tribunal (the 'Tribunal') has imposed a fine of \$70,000 (plus GST) on Commonwealth Securities Limited ('CommSec') for the incorrect treatment of certain Application Monies¹ and Additional Margins² which were incorrectly withdrawn from the Trust Account and transferred to the Trading Account. This treatment contravened the following ASX Market Rules in effect at the time of the Contraventions:

1. ASX Market Rule 7.11.1* – CommSec failed to comply with the relevant provision of the Corporations Act 2001 (Cth) (the 'Act') and the Corporations Regulations 2001 (Cth) (the 'Regulations') in relation to Application Monies and Additional Margins for the period from 11 March 2004 to 3 March 2010 ('Contravention 1'); and
2. ASX Market Rule 7.11.10* – CommSec failed to perform reconciliations that were accurate in all respects in that those reconciliations failed to identify all Application Monies and Additional Margins that were required by the Act to be held in a Trust Account for the period required by the Act, as per the time, form and manner set out in the Procedures from on-or-around 6 October 2009 to 3 March 2010 ('Contravention 2').

CommSec elected not to contest the contraventions before the Tribunal.

The circumstances of the matter are detailed as follows:

At all material times CommSec operated the Trust Account into which it deposited Application Monies and Additional Margins. The System used to facilitate this operation is an automated back office system that is used extensively in the Australian financial markets (the 'System'). In early 2010, CommSec discovered the incorrect treatment of certain Application Monies and Additional Margins by the System.

Between 11 March 2004 to 3 March 2010 CommSec's clients transferred funds to CommSec – when buying rights on market – for the purposes of taking up entitlement issues, applying for securities or taking up other types of offers for securities by a company ('Issuer').

When a client of CommSec applied for securities on market through CommSec, a 'renounceable issue corporate action' was generated in the System. The System recognised the type of transaction in a default setting and automatically generated an 'application money' account which was attached to the trade on a confirmation note.

1 Funds paid by clients of CommSec and held by it on behalf of the client, for the purposes of exercising rights issues upon acquisition of the right, or taking up any other type of offer for securities by an Issuer.

2 Funds paid by clients of CommSec, and held by it on behalf of the client, for the purposes of providing additional cash collateral required by CommSec in excess of and in addition to any cash or securities collateral required by the ACH Clearing Rules, in connection with the sale by the client of Options Market Contracts.

The client paid for rights and transferred the Application Monies to CommSec. The System flagged these items (Application Monies) as 'trustable' (ie monies to which s 981A and s 981B(1)(c) of the Act and Regulation 7.8.01(5) of the Regulations applied). Therefore the Application Monies appeared as items in the trust report and were deposited into the Trust Account on receipt from CommSec's clients. The Application Monies remained in the Trust Account until the date of the allocation of scrip (to the client).

However, the System failed to retain the Application Monies as items in the trust report from the time of the allocation of the scrip to the client to the date of payment to the Issuer. This failure by the System resulted in Application Monies received, and subsequently paid to the Issuer, being excluded from the Trust Account from the time of allocation of scrip to the date of payment, instead of being retained until the date of payment.

As the Application Monies which referred to the closed scrip lines did not appear as items in the trust report, those funds were incorrectly withdrawn from the Trust Account and transferred to the Trading Account.

As a result, over at least a six year period, CommSec failed to retain Application Monies in trust from the time of allocation of scrip to the payment of funds to the Issuer for the benefit of the persons entitled to that money and Application Monies. A total value of approximately \$71,828,232 was withdrawn in error from the Trust Account during this time.

The Additional Margins were monies to which Division 2 of Part 7.8 of the Act applied.

The relevant accounts used within the System for Additional Margins – 'Additional Margin Control Account' were outside the range of 'trustable' accounts. As a result, the Additional Margins were being accounted for in a non-trustable account type, and the Additional Margins were transferred at the end of each day automatically, and incorrectly, from the Trust Account to the Trading Account.

Consequently, between 11 March 2004 to 3 March 2010, Additional Margins to the total value of approximately \$9,320,610 ceased to be held in the Trust Account, on trust, for the benefit of the persons entitled to that money.

CommSec contravened Market Rule 7.11.10 in that CommSec did not perform the reconciliations required by the Rule in a manner which would identify all Application Monies and Additional Margins that were required by the Act to be held in a Trust Account until such time as the Application Monies and Additional Margins were not required to be held in trust.

CommSec, while performing the reconciliations in accordance with the form set out in the ASX Market Rules and the corresponding Procedure, did not perform the reconciliations in a manner which included a process by which CommSec could manually (if necessary) identify all Application Monies and Additional Margins to ensure that the Application Monies and Additional Margins were treated in accordance with requirements of the ASX Market Rules and the Act.

In determining penalty, the Tribunal took into account a number of matters, including the following:

- CommSec fully co-operated with ASX in relation to the conduct of its investigation into the contraventions;
- the misconduct was unintentional;
- at no stage was any CommSec client negatively impacted or any market transaction not enabled as a result of the contraventions;
- the misconduct was self-reported in a timely and comprehensive manner;
- there was no commercial advantage or financial benefit obtained as a result of the misconduct;
- CommSec has promptly implemented remedial measures to prevent any recurrence of the contravening conduct;
- CommSec has a previous disciplinary history;
- the relevant misconduct occurred over an extended period of time (approximately six years); and
- the relevant misconduct had the potential to damage the reputation and integrity of the ASX and the market and facilities it operates.

Disciplinary Tribunal Sanction Guidelines

A substantial part of the conduct in this matter occurred after 31 March 2008. From 31 March 2008 until 1 August 2010, the ASX Disciplinary Processes and Appeals Rulebook (the 'Rulebook') established uniform disciplinary and appeal processes for the Licensees of the Australian Securities Exchange.

Accordingly, the Tribunal was bound by the sanction guidelines (Annexure A to the Rulebook) in making its determination as to sanction in this matter. The Tribunal also had due regard, where applicable, to the sanction guidelines in place prior to the introduction of the Rulebook.

In accordance with the sanction guidelines at Annexure A, the Tribunal determined that the contravention of the ASX Market Rules was appropriately classified as a Level 2 (Serious Contravention), for which the applicable penalty range is \$20,000 - \$100,000 (plus GST).

The Tribunal considered the aggravating and the mitigating circumstances in each contravention.

Given the aggravating and mitigating circumstances in this matter, the Tribunal determined that the total fine of \$70,000 (plus GST) for both contraventions represents an appropriate sanction in the circumstances.

The Tribunal's opinion is that this sanction will serve as a deterrent to other participants and their representatives from engaging in similar misconduct while at the same time appropriately serve the interests of ASX and market participants by supporting the integrity of the market it operates.

* On 1 August 2010, the supervision of trading on Australia's domestic licensed markets and the supervision of trading participants transferred from ASX to the Australian Securities and Investments Commission. The conduct that is the subject of these contraventions occurred prior to the transfer date. ASX will continue to manage, and bring before the Tribunal, disciplinary matters for potential breaches of its operating rules occurring before the transfer date.

As part of the transfer, a number of changes were made to the rules, including the replacement of the ASX Market Rules by the ASX Operating Rules. Potential operating rule breaches which occurred prior to 1 August 2010 will be dealt with in accordance with the rules in place at the time of the alleged breach.