

ASX Circular

Date: 24 November 2009

Key topics

1. ETRADE Australia Securities Limited

Reading List

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

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DISCIPLINARY MATTERS

The ASX Disciplinary Tribunal has determined the following:

ETRADE Australia Securities Limited contravened ASX Market Rule 7.11.1 on six occasions between 12 September 2006 and 21 February 2007, by ceasing to hold monies on trust in its relevant Trust Accounts for the benefit of the persons entitled to those monies. ETRADE thereby failed to hold on trust, money to which Division 2 of Part 7.8 of the Corporations Act 2001 ('the Act') applied and failed to comply with section 981B(1)(c) of the Act and Regulation 7.8.01(5) of the Corporations Regulations 2001.

ETRADE did not contest the matter.

For these contraventions the Tribunal imposed a fine of \$75,000 (plus GST).

The circumstances of this matter are detailed as follows:

The contraventions arose in connection with ETRADE's dealings with client money and its operation of various Trust Accounts following its acquisition of two portfolios of stockbroking customers ('the Acquired Business') from two major banks ('the Banks').

Contraventions 1 and 2

After ETRADE assumed operational control of the Acquired Business, the customers maintained linked bank accounts ('Bank Accounts') with the Banks. ETRADE allowed its customers to trade through ETRADE on the basis that sufficient funds were in the customer's Bank Account at the time of placing an order. When a customer purchased securities through ETRADE, ETRADE understood that the Banks 'locked' the funds in the accounts and, prior to settlement on T+3, a direct debit instruction would cause the funds to be transferred to one of two trust accounts maintained by ETRADE ('Trust Accounts 1 and 2').

On or around 12 September 2006 and 14 September 2006, Trust Accounts 1 and 2 became overdrawn by \$999,144.67 and \$226,737.91 respectively. This was caused by a failure of the direct debit arrangements between the Bank Accounts and the Trust Accounts. As a result of ETRADE's automated settlement processes, Trust Accounts 1 and 2 were debited for amounts to settle purchase transactions. The effect of this was that the Trust Accounts became substantially overdrawn. ETRADE deposited funds into the Trust Accounts to ensure that they were promptly restored to positive balances.

Contravention 3

On or around 3 November 2006, a trust account operated by ETRADE ('Trust Account 3') went into deficit by \$288,000. ETRADE had been given incorrect account details which prevented it from transferring client funds from the clients' bank accounts into Trust Account 3 to settle transactions. ETRADE's automated settlement processes meant that Trust Account 3 was debited for amounts to settle purchase transactions to the effect that Trust Account 3 became substantially overdrawn. ETRADE deposited funds into Trust Account 3 to ensure that it was promptly restored to a positive balance.

On 10 November 2006, ETRADE accounts staff processed batch settlement from a trust account ('Trust Account 4'). Error messages were received from the bank that maintained Trust Account 4 indicating that the files had exceeded the permitted batch limit. ETRADE staff consequently re-sent the files in smaller batches. However, the bank processed both the earlier batch and the subsequent batches. This resulted in Trust Account 4 being overdrawn from Friday 10 November 2006 until Monday 13 November 2006 by \$154,279,665.20. On 13 November 2006 the settlement error was identified and subsequently corrected.

Contravention 5

On 8 February 2007, ETRADE attempted to transfer funds from Trust Account 3 to its general account. As a result of a transposition error, an ETRADE employee placed the wrong trust account details in the transfer instructions and the funds were in fact transferred from Trust Account 2. As a result Trust Account 2 became overdrawn by \$178,526.19. The error was identified and rectified on 9 February 2007 when a daily reconciliation was performed.

Contravention 6

On 21 February 2007, ETRADE attempted to transfer funds to Trust Account 2. An error was made by an ETRADE employee who failed to upload one of the 14 bank files required as part of the transfer. As a consequence of the error, Trust Account 2 became overdrawn by \$4,770,743.44.

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

- a) The importance of the obligations imposed on Market Participants in relation to the handling of client money;
- b) The misconduct was indicative of a pattern of non-compliance with the Rules by ETRADE, arising out of issues associated with taking control of the Acquired Business;
- c) ETRADE's previous disciplinary history. ETRADE has been fined on nine previous occasions by the ASX Disciplinary Tribunal. ETRADE had been fined on four occasions when the events which are the subject of this determination took place. ETRADE has not previously been sanctioned in respect of a contravention of ASX Market Rule 7.11.1;
- d) All the incidents referred to were self-reported to the ASX in a timely manner;
- e) ETRADE fully cooperated with ASX in relation to the conduct of its investigation into the matter;
- f) ETRADE agreed at the earliest opportunity not to contest the contraventions;
- g) The contraventions occurred a number of years ago under different management prior to the takeover by its current owners;
- h) At no stage was any customer negatively impacted or any market transaction not enabled;
- i) A number of the incidents were partially as a result of failures by third parties;
- j) There was no commercial benefit to ETRADE as a result of the incidents;
- k) The internal incident reporting and management processes within ETRADE have been significantly upgraded post the change in ownership to be in alignment with those of the parent company; and
- l) Large scale reviews by independent consultants were commissioned by ETRADE into the circumstances of the breaches and to identify the underlying causes. The recommendations arising out of these reviews have been implemented.

The misconduct occurred before 31 March 2008, that being the effective time under the Australian Securities Exchange Disciplinary Processes and Appeals Rulebook. Therefore, the applicable Tribunal sanction guidelines are those contained in ASX Market Rules Guidance Note 18 which was in effect at the material time. The Tribunal determined that these contraventions were classified as Level 2 Serious Contraventions, for which the applicable penalty range is \$20,000 - \$100,000 (plus GST).

Taking into account the mitigating and aggravating circumstances in this matter, the Tribunal determined that a fine of \$75,000 (plus GST) was an appropriate sanction. The Tribunal intends to send a clear message to Market Participants regarding the seriousness of Trust Account breaches and the importance of the obligations on Participants in relation to the holding of client trust money in Trust Accounts. The Tribunal also noted that ETRADE self-reported these contraventions and that this was a significant mitigating factor in the seriousness of this conduct. Self-reporting is indicative of a corporate culture of compliance which the Tribunal considers very important in promoting the integrity of the markets.

An important function of the ASX and the Market Rules is to maintain the reputation and integrity of the market. The Tribunal is satisfied that the imposition of this fine will act as a deterrent and appropriately serves the purposes of protecting the interests of ASX and its participating organisations, and of promoting confidence in the integrity of the markets.