

ENFORCEABLE UNDERTAKING

Australian Securities and Investment Commission Act 2001

Section 93AA

The commitments in this undertaking are offered to the Australian Securities & Investments Commission by:

Patersons Securities Limited
ACN 008 896 311
Level 23, Exchange Plaza
2 The Esplanade
PERTH WA 6000

A. BACKGROUND

1. Definitions

- 1.1 In addition to terms defined elsewhere in this undertaking, the following definitions are also used:

Canberra Clients means the clients who opened advisory accounts at the Canberra office of Patersons, whose accounts were managed under the 'CAN' account by Eric Hawley, Scott McAlister and staff of the Canberra office of Patersons.

Compliance Procedures means the procedures which Patersons has implemented for it to comply with the terms of its AFSL (no. 239052), the Australian Stock Exchange Limited ("ASX") Market Rules, the Corporations Act and the ASIC Act.

Compliance Documentation means all documentation, manuals, reports, guides, intranet websites and other forms of documentation and presentation which set out the Compliance Procedures, and any other measures demonstrating how Patersons implements AS3806-2006.

2. Introduction

- 2.1 The Australian Securities & Investments Commission ("ASIC") is responsible for monitoring and promoting market integrity and consumer protection in the Australian financial system.
- 2.2 Patersons Securities Limited ("Patersons") is a company carrying on business as a stockbroker and is the holder of Australian Financial Services Licence ("AFSL") no. 239052.
- 2.3 Scott McAlister ("McAlister") and Eric Hawley ("Hawley") joined the Canberra office of Patersons in October 2004 and January 2005 respectively. Prior to this they had been working

as stockbrokers with Ord Minnett Limited ("**Ords**"). During his employment at Patersons, Hawley was the manager and senior broker of the Canberra office of Patersons.

- 2.4 When Hawley and McAlister joined Patersons, approximately 700 clients whom they had advised while at Ords, opened accounts with Patersons. Approximately 216 of these transferred open derivatives positions into the accounts opened at Patersons. Although working for a new organisation, the investment and trading strategies of Hawley and McAlister, and all other aspects of their client relationships, remained largely unchanged.

3. **Paterson notification and ASIC surveillance and investigation**

- 3.1 On 10 November 2005 Patersons notified ASIC, pursuant to section 912D of the *Corporations Act 2001* (Cth) ("**Corporations Act**"), that Hawley and McAlister may have failed to provide more than 500 clients with Statements of Advice as required by the Corporations Act. Patersons also notified ASIC that it was investigating the advice provided by Hawley and McAlister to a smaller group of clients who had experienced poor investment performance.

- 3.2 After receiving the notification from Patersons, ASIC commenced a surveillance of Patersons.

- 3.3 On 23 December 2005 ASIC commenced an investigation into suspected contraventions of ss945A, 952C, 952D, 952E, 1041E, 1041F and 1041G of the Corporations Act, ss12CA, 12DA and 12DB of the *Australian Securities & Investments Commission Act 2001* (Cth) ("**ASIC Act**"), s332 of the *Criminal Code 2002* (ACT) and s178BA of the *Crimes Act 1900* (NSW), by employees of Patersons, in relation to trading on behalf of, and dealing in the accounts of, clients of Patersons.

4. **ASIC's concerns**

- 4.1 As a result of the surveillance and investigation conducted by ASIC and the notifications made by Patersons, ASIC has the following concerns.

- 4.2 At both Ords and Patersons, Hawley and McAlister operated discretionary accounts for a significant number of the clients. At Patersons they operated these accounts without the appropriate authority, without completing the appropriate discretionary management authorisation documentation and contrary to the direction of Patersons.

- 4.3 In the course of operating the discretionary accounts Hawley and McAlister entered into derivatives transactions on behalf of up to 216 clients. ASIC is concerned that the derivative transactions exposed a significant number of those clients to significant risk from share price movements.

- 4.4 ASIC is concerned that a significant number of clients were not aware that the options positions opened and/or rolled over by Hawley and McAlister at Patersons meant that they were exposed to increasing losses in a rising market and that the options positions were contrary to the portfolio that the clients had requested. Further, ASIC is also concerned that the derivatives positions entered into for a significant number of clients were inappropriate to their circumstances and that the risks of these positions were not understood by the clients.
- 4.5 ASIC is also concerned that when clients queried transactions on their accounts, Hawley and McAlister provided them with misleading assurances or evasive answers.
- 4.6 Section 945A of the Corporations Act requires a person to have a reasonable basis for the advice provided to a client, including determining the relevant personal circumstances of the client and having regard to those circumstances when providing advice.
- 4.7 ASIC is concerned that a significant number of Hawley and McAlister's clients were not given appropriate or accurate advice, when either agreeing to enter into the derivative transactions or agreeing to give Hawley and McAlister authority to trade on their accounts, or in relation to the risks associated with trading in derivatives.
- 4.8 Section 946A of the Corporations Act requires a person providing financial advice, including advice about shares and options, to give the person receiving the advice a document called a Statement of Advice ("SoA"). The SoA must, amongst other things, set out the advice given and the basis for that advice.
- 4.9 ASIC is concerned that between January 2005 and November 2005 Hawley and between October 2004 and November 2005 McAlister failed to give a significant number of clients SoAs when they provided them with financial advice.
- 4.10 ASIC is concerned that Patersons provided inadequate supervision of Hawley and McAlister, such that Patersons failed to prevent Hawley and McAlister from conducting unauthorised discretionary trading on a large number of client accounts.
- 4.11 ASIC is concerned that Patersons had inadequate systems and procedures in place relating to:
- (a) monitoring and supervision of the provision of advice to clients in the Canberra office of Patersons;
 - (b) monitoring and supervision of the provision of financial services in the Canberra office of Patersons;

- (c) monitoring and supervision of the management of discretionary and non-discretionary client accounts in the Canberra office of Patersons;
- (d) monitoring and supervision of the trading conducted by staff in the Canberra office of Patersons;
- (e) induction and training of staff in the Canberra office of Patersons;
- (f) transfer of clients and open derivatives positions from Ords to Patersons; and
- (g) record keeping obligations in respect of the provision of advice and the execution of transactions in the Canberra office of Patersons.

5. **Patersons' response**

- 5.1 Patersons states that it undertook checks to establish and verify Hawley and McAlister's expertise, fame and good character before engaging them which revealed that Hawley and McAlister were both PS146 qualified and ASX Derivatives Level 2 accredited. In addition, Patersons considered that Hawley was extremely well-credentialed, had occupied senior positions (including those of Executive Director and manager of Ords' Canberra office) over a long period of time at Ords.
- 5.2 Patersons also states that it was not responsible for initiating derivatives positions that were opened at Ords and subsequently transferred to Patersons when clients opened accounts at Patersons.

6. **Acknowledgement of concerns**

- 6.1 Whilst Patersons does not agree with all aspects of ASIC's concerns, Patersons acknowledges ASIC's concerns and states that it has already commenced remedial action to address a number of those concerns. In addition, Patersons has offered, and ASIC has agreed to accept, undertakings in the terms set out below.
- 6.2 ASIC acknowledges that Patersons has co-operated with ASIC during its investigation. ASIC further acknowledges that Patersons, of its own accord, promptly reported the breach to ASIC and that Patersons interviewed most of the Canberra Clients, reviewed all derivatives accounts, began processing complaints and undertook its own investigations into the breaches, as soon as it was alerted to them.
- 6.3 Without derogating from the operation of the provisions of paragraphs 8.4 and 8.6 below, Patersons acknowledges that ASIC is reviewing the process that Patersons is undertaking to

deal with complaints received from the Canberra Clients, and acknowledges that ASIC's acceptance of this Undertaking does not affect ASIC's power to take further action in relation to this process and any losses suffered by the Canberra Clients.

- 6.4 ASIC also acknowledges that Patersons has already engaged KPMG to conduct a review of its compliance procedures and processes ("**Compliance Review**") and implemented a plan to prevent the re-occurrence of issues of concern to ASIC.
- 6.5 ASIC has agreed to accept undertakings in the terms below as an alternative to seeking to cancel, suspend or impose additional conditions on, or otherwise varying the conditions currently imposed on AFSL number 239052, under Part 7.6 of the Corporations Act, or commencing proceedings against Patersons, in relation to breaches of the sections set out above and/or breaches of the conditions of Patersons' licence.

B. UNDERTAKINGS

Under s.93AA of the ASIC Act, Patersons has offered, and ASIC has agreed to accept, the following undertakings:

7. **Continuation of Compliance Review**
- 7.1 Within 30 days of the date of this undertaking Patersons will provide KPMG with an amended terms of engagement requiring the Compliance Review to include the matters referred to in this undertaking.
- 7.2 The amended terms of engagement must be approved by ASIC prior to them being provided to KPMG.
- 7.3 All remuneration and costs associated with KPMG shall be borne by Patersons.
- 7.4 The amended terms of engagement must ensure that KPMG conducts a review of:
- (a) the Compliance Procedures;
 - (b) the Compliance Documentation; and
 - (c) Patersons' implementation of the procedures and controls to ensure compliance with (a) and (b) above:

in relation to the following:

- (i) Process for the establishment, management and supervision of discretionary trading accounts.

- (ii) Process for the establishment, management and supervision of options trading.
- (iii) Provision of advice and SoAs.
- (iv) Processes for monitoring, supervision and training of authorised representatives and other staff, including compliance with PS146.
- (v) Processes for identification and monitoring (including remote monitoring) risk of non-compliance with the terms of Patersons' AFSL, the Corporations Act, the ASIC Act, ASX Market Rules and other laws relating to financial services and AFS licence conditions.
- (vi) Implementation of risk management procedures and how the Patersons' risk management system meets best practice as set out in AS 4360.
- (vii) Processes for ensuring that authorised representatives will not act outside the scope of their authorisation.
- (viii) Processes for addressing non-compliance by representatives.
- (ix) Processes to ensure that Patersons has sufficient organisational capacity to provide the financial services covered by its AFSL, in accordance with Policy Statement 164.
- (x) How Patersons' compliance arrangements meet best practice as set out in AS 3806-2006.
- (xi) Frequency, extent and nature of compliance reporting.
- (xii) Reporting, escalation and resolution of compliance breaches.
- (xiii) Monitoring and rectifying systemic breaches.
- (xiv) Processes for establishing and maintaining requisite records in respect of the provision of advice and the execution of transactions.
- (xv) Process for managing the transfer of clients and positions into and out of Patersons in accordance with ASX Market Rules Guidance Note No. 4.

7.5 The amended terms of engagement must ensure that KPMG provides a report to Patersons and ASIC within six months after the date of this undertaking ("**Initial Report**").

- 7.6 If KPMG identifies deficiencies in respect of the review referred in paragraph 7.4, the amended terms of engagement must ensure that KPMG sets out in the Initial Report details of the deficiencies and recommendations on how to rectify the deficiencies.
- 7.7 Patersons must consider the recommendations made by KPMG to remedy those deficiencies and then provide to ASIC a plan ("**Remedial Action Plan**") setting out the action it proposes to take to rectify those deficiencies and specifying the time in which this action will be taken. Patersons must provide this plan to ASIC within one month of the date that the Initial Report was received by ASIC.
- 7.8 Patersons must implement the Remedial Action Plan within the time specified in the Remedial Action Plan. If ASIC requests any reasonable modifications to the Remedial Action Plan Patersons must implement the Remedial Action Plan as modified.
- 7.9 Within six months of the Initial Report, Patersons must engage a Compliance Expert to review the matters referred to in paragraph 7.4 and the implementation and effectiveness of the Remedial Action Plan ("**Second Report**"). The Compliance Expert may be the same expert as the expert retained to complete the Initial Report. The Second Report must be provided to ASIC.
- 7.10 If the Compliance Expert identifies deficiencies in respect of the review referred to in paragraph 7.4 and/or in respect of the implementation or effectiveness of the Remedial Action Plan, the terms of engagement must ensure that the Compliance Expert sets out in the Second Report, details of the deficiencies and recommendations on how to rectify those deficiencies.
- 7.11 If the Second Report identifies deficiencies, Patersons must consider the recommendations made by the Compliance Expert to remedy those deficiencies and then provide to ASIC a plan ("**Second Remedial Action Plan**") setting out the action it proposes to take to rectify those deficiencies, and specifying the time in which this action will be taken. Patersons must provide this plan to ASIC within one month of the date that the Second Report was received by ASIC.
- 7.12 Patersons must implement the Second Remedial Action Plan within the time specified in the Second Remedial Action Plan. If ASIC requests any reasonable modifications to the Second Remedial Action Plan, Patersons must implement the Second Remedial Action Plan as modified.
- 7.13 Within one year of the Second Report, Patersons must engage a Compliance Expert to review the matters referred to in paragraph 7.4 and the implementation and effectiveness of the Second Remedial Action Plan ("**Final Report**"). The Compliance Expert may be the same

expert as the expert retained to complete the Initial and Second Reports. The Final Report must be provided to ASIC.

- 7.14 If the Compliance Expert identifies deficiencies in respect of the review referred to in paragraph 7.4 and/or in respect of the implementation or effectiveness of the Second Remedial Action Plan, the terms of engagement must ensure that the Compliance Expert sets out in the Final Report details of the deficiencies and recommendations on how to rectify those deficiencies.
- 7.15 If the Final Report identifies deficiencies, Patersons must consider the recommendations made by the Compliance Expert to remedy those deficiencies and then provide to ASIC a plan ("**Third Remedial Action Plan**") setting out the action it proposes to take to rectify those deficiencies, and specifying the time in which this action will be taken. Patersons must provide this plan to ASIC within one month of the date that the Final Report was received by ASIC.
- 7.16 Patersons must implement the Third Remedial Action Plan within the time specified in the Third Remedial Action Plan. If ASIC requests any reasonable modifications to the Third Remedial Action Plan, Patersons must implement the Third Remedial Action Plan as modified. Patersons will provide to ASIC a written report, detailing the implementation of the Third Remedial Action Plan within 14 days of the final step in the Third Remedial Action Plan being completed.
- 7.17 Patersons will ensure that the terms of engagement of KPMG and any other Compliance Expert(s) will include a requirement that any reports required to be prepared by the Compliance Experts, under this undertaking, will:
- (a) set out the steps that the Compliance Expert has taken to fulfil his or her task, including but not limited to:
 - (i) the personnel that have assisted the Compliance Expert and in what way;
 - (ii) the personnel that have been interviewed; and
 - (iii) the documents that have been reviewed;
 - (b) set out any limitations or qualifications to the reports;
 - (c) list those documents or extracts of documents most relevant (in the view of the Compliance Expert) in producing the reports;

- (d) otherwise comply (to the extent applicable) with those paragraphs of the Federal Court of Australia, Practice Direction entitled "Guidelines for Expert Witnesses in proceedings in the Federal Court of Australia", that fall under the sub-heading "The form of the expert evidence";
- (e) set out any amendments that were made, by Patersons, to the Compliance Procedures and the Compliance Documentation during the course of the Compliance Expert's review of the Compliance Procedures and Compliance Documentation, and the reasons for those amendments.

7.18 Patersons must provide reasonable access and assistance and take all reasonable steps to allow KPMG and any other Compliance Expert to be able to fulfil the terms of their appointment.

8. **Acknowledgements**

8.1 Patersons acknowledges that ASIC may write to any of the Canberra Clients of Patersons in relation to the matters referred in this undertaking.

8.2 Patersons acknowledges that ASIC:

- (a) may issue a media release on execution of this undertaking referring to its terms and to the concerns of ASIC which led to its execution;
- (b) may from time to time publicly refer to this undertaking; and
- (c) will make this undertaking available for public inspection.

8.3 Patersons acknowledges that this undertaking in no way derogates from the rights and remedies available to any third party arising from any conduct described in this undertaking.

8.4 Patersons acknowledges that ASIC's acceptance of this undertaking does not affect ASIC's power to investigate, conduct surveillance or pursue a criminal prosecution or its power to lay charges or seek a pecuniary civil order in relation to any or all of the conduct described in this undertaking or any contravention arising from future conduct.

8.5 Patersons acknowledges that this undertaking has no operative force until accepted by ASIC.

8.6 Patersons acknowledges that should ASIC form the view that Patersons has failed to comply with this undertaking, ASIC may take additional action including seeking court orders under s93AA of the ASIC Act, requiring Patersons to comply with the terms of this undertaking.

9. **Miscellaneous**

9.1 If any obligation, referred to in this undertaking, arises on a weekend or holiday, then the obligation is deemed to arise on the first business day after that day.

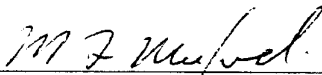
9.2 The address for providing ASIC with any document, which is required by this undertaking is:

Director
Compliance
Australian Securities & Investments Commission
GPO Box 9827
Melbourne VIC 2000

9.3 The address for providing Patersons with any document, which is required by this undertaking is:

Company Secretary
Patersons Securities Limited
GPO Box W2024
Perth WA 6846

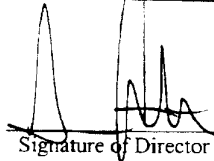
The Common Seal of Patersons Securities Limited was affixed in accordance with the *Corporations Act 2001* in the presence of:



Signature of Secretary/other Director

MILITARE FRANK MITNIZKO

Name of Secretary/other Director in full

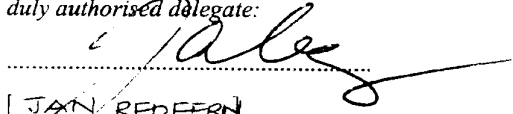


Signature of Director

ARON ROBERT CONSTANTINE

Name of Director in full

Accepted by the Australian Securities & Investments Commission under the ASIC Act section 93AA by its duly authorised delegate:



[JAN REDFERN]

Delegate of Australian Securities & Investments Commission

Date: 5 DECEMBER 2006