



## ENFORCEABLE UNDERTAKING

*Australian Securities and Investments Commission Act 2001*

Section 93AA

The commitments in this undertaking are offered to the Australian Securities and Investments Commission (ASIC) by:

*Paul Martin Kennedy*

*3 Carroll Road, Heathfield, South Australia, 5153*

### 1. Definitions

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

**AFSL** means Australian financial services licence;

**ASIC Act** means the *Australian Securities and Investments Commission Act 2001* (Cth);

**ASX** means Australian Securities Exchange Limited;

**Corporations Act** means the *Corporations Act 2001* (Cth);

**Corporations Regulations** means the Corporations Regulations 2001 (Cth);

**MBL** means Macquarie Bank Limited ACN 008 583 542;

**MEL** means Macquarie Equities Limited ACN 002 574 923, holder of AFSL no. 237504 and a participating organisation of the ASX;

**MIL** means Macquarie Investment Lending a division of MBL;

**MTP** means Macquarie Trading Power, a margin lending facility offered by MIL which allowed clients to buy or sell options against shares held as security in their margin loan accounts or to short sell those shares. MTP also permitted higher levels of gearing through the use of put options on held stock;

**MTP clients** means those clients of MEL that operated a MTP facility and traded options contracts;

**Mr Kennedy** means Paul Martin Kennedy of 3 Carroll Road, Heathfield, South Australia, 5153.

## 2. Background

### 2.1 ASIC's role

- 2.1.1 Under section 1 of the ASIC Act, ASIC is charged with a statutory responsibility to perform its functions and to exercise its powers so as to promote the confident and informed participation of investors and consumers in the financial system.

### 2.2 Details of Conduct

- 2.2.1 Between 1 December 2006 and 15 July 2008 Mr Kennedy was employed by MBL as a Private Client Advisor in its Adelaide office.
- 2.2.2 During that time a number of MEL clients that Mr Kennedy advised used MTP to finance options trading on an account with MEL.
- 2.2.3 MEL's internal procedures did not require a separate account to be created to hold MTP clients' margin lending collateral. An MTP client's margin lending collateral and the collateral supporting the MTP client's options positions were held in the one derivatives clearing account.
- 2.2.4 As a consequence it was possible for the same options contract (specifically bought put positions) to be pledged as collateral to support both the MTP leveraging and the client's trading position, resulting in the appearance of a greater level of security than was actually supported by the MTP client's assets, and permitting MTP clients to access a higher level of leveraging than would otherwise have been available.
- 2.2.5 This was the case with MTP clients that Mr Kennedy advised prior to September 2007.
- 2.2.6 In about July 2007 MEL became aware of the consequence outlined in paragraph 2.2.4 above and the associated risks.
- 2.2.7 On 3 September 2007 MEL management representatives met with Mr Kennedy and for the first time raised with him MEL's concerns about the risks to his clients associated with the procedures referred to in paragraph 2.2.3. Prior to this meeting the risks had not been understood by Mr Kennedy nor communicated to his clients.
- 2.2.8 During the discussion Mr Kennedy acknowledged that the practice exposed MTP clients to a higher level of risk. Those clients that Mr Kennedy advised who were exposed to this higher level of risk were identified. MEL outlined three strategies that would enable the clients to continue to trade, but with an acceptable level of risk and Mr Kennedy was instructed to adopt one of these strategies in respect of each of the MTP clients.
- 2.2.9 Mr Kennedy agreed to operate within the framework mandated by MEL and initially reported to MEL that he had adopted one of the approved strategies in respect of each of the MTP clients, specifically that he had purchased put options contracts to provide a floor for the client's trading additional to the contracts held as security for the MTP facility.

- 2.2.10 MEL relied on Mr Kennedy to continue operating within the framework referred to in paragraph 2.2.8 above in respect of each MTP client as had been agreed by him.
- 2.2.11 From about January 2008, in respect of some of the MTP clients, Mr Kennedy ceased to operate within the framework mandated by MEL and ceased purchasing the additional put options required for the strategy he had undertaken to adopt. This had the effect of significantly increasing the risk for a number of MTP clients, who became significantly over-gearred and exposed to potentially substantial losses in relation to some of the positions they held.
- 2.2.12 Mr Kennedy did not fully explain to the MTP clients the consequent risks of trading outside the framework mandated by MEL.
- 2.2.13 At the time the conduct was reported to ASIC MEL estimated that the MTP clients had been exposed to losses totalling approximately \$6 million.
- 2.2.14 MEL and those MTP clients that incurred a loss have reached an agreement in respect of those losses.
- 2.2.15 On 15 July 2008 MEL terminated Mr Kennedy's employment and representative authorisation.

### **2.3 ASIC's investigation**

- 2.3.1 ASIC has conducted an investigation into the conduct of Mr Kennedy during the period 1 September 2007 to 15 July 2008 and in particular as to whether he contravened Chapter 7 of the Corporations Act with respect to his trading on account of MTP clients.

### **2.4 ASIC's concerns**

- 2.4.1 As a result of its investigation, ASIC is concerned that Mr Kennedy:
  - 2.4.1.1 from September 2007 failed to adequately explain to MTP clients the risks of double pledging their put option protection;
  - 2.4.1.2 from September 2007 failed to fully inform MTP clients of the three strategies for containing their risk mandated by MEL at the meeting referred to in paragraphs 2.2.7 to 2.2.9 above, so as to enable them to make fully informed decisions;
  - 2.4.1.3 from about January 2008 to July 2008 without reference to MEL or to the affected clients, ceased to implement the agreed strategy of purchasing additional put option contracts to manage the risk of his MTP clients;
  - 2.4.1.4 for each of the affected MTP clients, exposed them to increased risk from about January 2008 to July 2008.
  - 2.4.1.5 failed to fully advise each MTP client of the potential risk that they were exposed to as a consequence of his failing to apply any of the three strategies mandated by MEL; and
  - 2.4.1.6 as a result of these failures and as a result of entering into trading positions, the MTP clients incurred losses.

2.4.2 ASIC is concerned that Mr Kennedy's conduct as outlined above resulted in each of the affected MTP clients suffering greater financial loss than otherwise may have been the case if one of the mandated strategies had continued to be followed.

2.4.3 ASIC is concerned that as a consequence of the conduct outlined above, Mr Kennedy has not complied with a financial services law or laws.

## **2.5 Acknowledgement of concerns**

2.5.1 Mr Kennedy acknowledges ASIC's concerns set out in paragraph 2.4 above.

2.5.2 Mr Kennedy states that his motivation for the conduct which is the subject of ASIC's concerns was fundamentally to assist MTP clients by improving their trading positions. However as the market deteriorated so did the position of the MTP clients.

2.5.3 Mr Kennedy states that his motivation was not personal monetary gain.

## **3. Undertakings**

3.1 Under s93AA of the ASIC Act, Mr Kennedy has offered, and ASIC has agreed to accept as an alternative to ASIC exercising its power under s920A of the Corporations Act to make a banning order against Mr Kennedy, the following undertakings:

- (a) Mr Kennedy undertakes that for a period of four years from the date of acceptance of this undertaking by ASIC he will not:
  - (i) provide a financial service or services as defined by the Corporations Act whether on his own behalf or on behalf of a person who carries on a financial services business as defined by the;
  - (ii) apply to ASIC under section 913A of the Corporations Act for an AFSL;
  - (iii) hold out that he is in any way authorised to provide a particular financial service or services or that he is in any way authorised to provide financial services generally; or
  - (iv) without the prior approval of ASIC accept employment, or enter into a contract for provision of services, with the holder of an AFSL or with any other person that carries on a financial services business.
- (b) Mr Kennedy undertakes to pay the costs of compliance with this enforceable undertaking.
- (c) Mr Kennedy will provide all documents and information requested by ASIC from time to time for the purpose of assessing Mr Kennedy's compliance with the terms of this enforceable undertaking.

**4. Acknowledgements**

4.1 Mr Kennedy acknowledges that ASIC:

- (a) may issue an advisory 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.

4.2 Further Mr Kennedy acknowledges that:

- (i) 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 contravention not the subject of ASIC's concerns as set out in paragraph 2.4 in this enforceable undertaking or arising from future conduct;
- (ii) this undertaking in no way derogates from the rights and remedies available to any other person or entity arising from any conduct described in this undertaking or arising from future conduct.

4.3 Mr Kennedy acknowledges that ASIC had reason to be concerned as to the alleged facts and has offered an enforceable undertaking in the terms of paragraph 3.1 above.

4.4 Mr Kennedy acknowledges that this undertaking has no operative force until accepted by ASIC, and Mr Kennedy and ASIC acknowledge that the date of the enforceable undertaking is the date on which it is accepted by ASIC.

.....*Paul Martin Kennedy*.....

Paul Martin Kennedy

Dated: *4.11.09*.....

Accepted by the Australian Securities and Investments Commission under s93AA of the ASIC Act by its duly authorised delegate:

.....*David John McGuinness*.....

David John McGuinness

Delegate of Australian Securities and Investments Commission

Date: *12/11/2009*.....