ASIC Gazette

Contents

Markets Disciplinary Panel Infringement Notice

Recipient: Commonwealth Securities Limited

The recipient has complied with the infringement notice. Compliance is not an admission of guilt or liability; and the recipient is not taken to have contravened subsection 798H(1) of the Corporations Act 2001.

RIGHTS OF REVIEW

Recipients affected by the decision of the Markets Disciplinary Panel to give them an infringement notice under subsection 798H(1) of the *Corporations Act 2001* and Part 7.2A of the *Corporations Regulations 2001* administered by ASIC may have a right of review or may be entitled to have the infringement notice withdrawn. ASIC has published RG 216 to assist recipients to determine whether they have such rights – see RG 216.71 and RG 216.77 to 216.79. Copies of this document can be obtained from the ASIC website at www.asic.gov.au

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**PART 7.2A OF THE CORPORATIONS REGULATIONS 2001
INFRINGEMENT NOTICE**

**To: Commonwealth Securities Limited
Ground Floor
Tower 1
201 Sussex Street
SYDNEY NSW 2000**

TAKE NOTICE: The Australian Securities and Investments Commission ("ASIC") gives this infringement notice to Commonwealth Securities Limited ACN 067 254 399 ("CommSec") under regulation 7.2A.04 of the Corporations Regulations 2001 ("Regulations"). To comply with this notice CommSec must:

> Pay a penalty to ASIC, on behalf of the Commonwealth, in the sum of **$300,000**.

This infringement notice is given on 4 August 2016.

The unique code for this notice as required by paragraph 7.2A.06(b) of the Regulations is MDP 3289/15.

The terms defined in Rule 1.4.3 of the *ASIC Market Integrity Rules (ASX Market) 2010* ("MIR 1.4.3") have the same meaning when used in this notice, including those set out in the Appendix to this notice. Certain additional defined terms used in this notice are also set out in the Appendix to this notice.

Alleged contravention and penalty

CommSec was a Market Participant in the Market operated by ASX Limited ("ASX") at the relevant time and was therefore an entity required by subsection 798H(1) of the *Corporations Act 2001* ("Act") to comply with the market integrity rules at that time.

CommSec is alleged to have contravened subsection 798H(1) of the Act by reason of contravening Rule 5.5.2 of the *ASIC Market Integrity Rules (ASX Market) 2010* ("MIR 5.5.2") which provides:

> *"A Trading Participant must have and maintain the necessary organisational and technical resources to ensure that:*
> > *(a)   Trading Messages submitted by the Trading Participant do not interfere with:*
> > > *(i)   The efficiency and integrity of the Market; or*
> > > *(ii)   The proper functioning of a Trading Platform; and*

> (b) the Trading Participant complies at all times with these Rules and the Market Operating Rules."

On the evidence before it, the Markets Disciplinary Panel ("MDP") was satisfied that:

1) Between 2 August 2010 and 14 April 2013 ("Relevant Period"), CommSec was a Trading Participant of the Market operated by ASX.

2) During the Relevant Period, CommSec accepted Orders from its clients for the sale of issuer sponsored holdings.

3) Prior to submitting Orders into the Market during the Relevant Period on behalf of its clients:

   (a) For the sale of issuer sponsored holdings valued at less than $10,000, CommSec did not verify:
       (i) the validity of the shareholder reference number ("SRN");
       (ii) the availability of the holding; or
       (iii) whether the name and address on the holding matched that of its Client.

   (b) For the sale of issuer sponsored holdings valued at greater than $10,000, CommSec verified that the SRN was valid and that the shares were available but did not verify whether the name and address on the holding matched that of its client.

4) Upon Order execution, CommSec issued a trade confirmation to its client, regardless of the name that appeared on the issuer sponsored holding that was sold.

5) At settlement, if the bank account linked to the CommSec trading account did not match the name on the issuer sponsored holding, CommSec would post the sale proceeds (less brokerage) in the form of a cheque to its client made payable to the name corresponding to the issuer sponsored holding.

6) During the Relevant Period, CommSec submitted approximately 161,589 Orders for the sale of issuer sponsored holdings , of which 101,157 were executed.

7) In the majority of instances involving the sale of issuer sponsored holdings, the name and address on the holding matched that of the CommSec client who provided the instructions.

8) However, it appears that approximately 5,546 (or 5.5% of 101,157) of the executed Orders for the sale of issuer sponsored holdings resulted in Market Transactions ("Relevant Transactions") in which the name and address on the holding did not match that of CommSec's client, which led to:

   (a) Approximately 5,546 trade confirmations being issued to the CommSec client instead of the shareholder;
   (b) Approximately 5,546 cheques being issued in the name of the shareholder, but posted to the client's address; and
   (c) Approximately 5,093 persons not receiving Financial Services Guides as 453 were found to be existing CommSec clients.

9) On 22 March 2013, CommSec identified issues in relation to its processes surrounding the sale of issuer sponsored holdings by existing CommSec clients.

10) From 15 April 2013, CommSec began verifying for all Orders that the name and address on the issuer sponsored holding matched that of the CommSec client account prior to the submission of an Order onto the Market.

11) CommSec notified the matter to ASIC on 20 September 2013.

By reason of CommSec's failure during the Relevant Period to have in place adequate organisation and technical procedures or controls that verified the name and address on an issuer sponsored holding matched that of the client who provided the instructions, prior to submitting the Orders for the sale of issuer sponsored holdings, CommSec failed to ensure that such Orders do not interfere with the efficiency and integrity of the Market. Accordingly, the MDP has reasonable grounds to believe that CommSec has contravened MIR 5.5.2 and thereby contravened subsection 798H(1) of the Act.

Maximum pecuniary penalty that a Court could order

The maximum pecuniary penalty that a Court could order CommSec to pay for contravening subsection 798H(1) of the Act by reason of contravening MIR 5.5.2 is $1,000,000.

The maximum pecuniary penalty that may be payable by CommSec under an infringement notice given pursuant to subsection 798K(2) of the Act, is $600,000.

Penalty under the Infringement Notice

The penalty payable under this infringement notice for the alleged contravention of subsection 798H(1) of the Act and therefore the total penalty that CommSec must pay to the Commonwealth is $300,000.

The penalty is payable to ASIC on behalf of the Commonwealth. Payment is made by bank cheque to the order of the "Australian Securities and Investments Commission".

In determining this matter and the appropriate pecuniary penalty to be applied, the MDP took into account all relevant guidance, including ASIC Regulatory Guide 216 – *Markets Disciplinary Panel,* and noted in particular the following:

12) MIR 5.5.2 is aimed at reinforcing the importance of having appropriate organisational and technical resources so that Orders incompatible with the efficiency and integrity of the Market are not submitted to the Trading Platform, and the ASIC Market Integrity Rules and the ASX Market Operating Rules are otherwise complied with.

13) It is a basic and necessary step in ensuring the bona fides of Orders to be submitted into the Market that a Trading Participant conducts verification that the name and address of an issuer sponsored holding match that of the client who provided the sale instructions.

14) Orders that are not bona fide and the unauthorised sale of issuer sponsored holdings have the potential to damage the efficiency and integrity of, and investor confidence in, the Market.

15) The conduct was reckless on the part of CommSec in the MDP's view, and indicative of widespread, systemic issues as there was a deliberate and material disregard by CommSec of its obligations under MIR 5.5.2. CommSec did not have in place the necessary technical and organisational procedures to ensure that the Orders it submitted to the Market for the sale of issuer sponsored holdings did not interfere with the efficiency and integrity of the Market nor did it ensure the bona fides of Orders prior to submission onto the Trading Platform.

16) CommSec was required to at all times ensure compliance with the market integrity rules and to detect any breaches of the rules in a timely manner, which it did not do.

17) Between 2 August 2010 and 14 April 2013, CommSec submitted Orders for the sale of issuer sponsored holdings without verifying for all Orders whether the name and address on the holding matched that of the Client who provided the sale instructions, in disregard of the risks for potential unauthorised sales and fraud.

18) This occurred notwithstanding that, on a daily basis, CommSec generated and reviewed a report of the instances in which the names of the registered shareholder and the client did not match. CommSec continued to permit the sale of issuer sponsored holdings without verifying that the name and address of the holding matched that of its Client, despite each of the daily reports providing an opportunity for CommSec to correct its practices.

19) This was not viewed favourably by the MDP because it appeared CommSec had accepted an inappropriate level of risk. A Market Participant is not entitled to make decisions, irrespective of its risk appetite, to not have in place the necessary organisational and technical resources to ensure compliance with the market integrity rules. Having policies that placed the onus on clients to verify ownership of the shares and accepting the risk that part or all of the shares (the subject of a sale) may not be available, was not acceptable.

20) CommSec also did not demonstrate prudent risk management procedures in deeming the risk of settlement failures to be minimal or non-existent by placing undue reliance on clients to confirm share ownership rather than conducting the requisite due diligence. This is especially so where there were 5,546 Relevant Transactions where the name and address of the shareholder did not match that of the CommSec client, evidencing a clear failing in CommSec's decision to rely on its clients to verify share ownership and the real risk for potential unauthorised sales and fraud. A policy to 'make good to the market' where shares were unavailable (for sale amounts less than $10,000), and a policy to make clients whole were any clients found to have suffered any fraud, is indicative of a complete failure to understand that the purpose of the market integrity rules is to regulate conduct to prevent and not remedy the efficiency and integrity of the Market being affected.

21) There was significant potential detriment to the third party registered owners of issuer sponsored holdings as CommSec's policies, processes and controls in respect of the sale of issuer sponsored holdings provided inadequate safeguards against potential fraud risk.

22) The conduct persisted over a material and unacceptable period of time, being a period for nearly three years, and pertained to 101,157 Orders for the sale of issuer sponsored holdings, of which 5,576 trade confirmations were issued to the CommSec client instead of the shareholder, 5,576 cheques were issued in the name of the shareholder, but posted to the client's address and 5,093 persons did not receive a Financial Services Guide as required.

23) CommSec also failed to remedy this breach in a timely manner. CommSec changed its procedures only from 15 April 2013, such that all Orders could not be executed without verification of the Client's ownership of the shares, prior to submitting Orders to the Market for the sale of issuer sponsored holdings. On or around 2 September 2013, CommSec concluded that confirmations needed to be given to the shareholder, and no actual detriment was caused to third parties.

24) Following discussions with ASIC, between 29 April 2015 and 18 June 2015 CommSec attempted to contact 22,643 persons and entities whose issuer sponsored holdings were sold through a CommSec account. CommSec did not receive any complaints from these persons and entities alleging that any of the transactions were carried out without the consent of the shareholder.

25) CommSec has changed its procedures such that all Orders require verification of the client's ownership of the shares, prior to submitting Orders to the Market for the sale of issuer sponsored holdings.

26) CommSec did not self-report the breach to ASIC under section 912D of the Act within 10 business days, as required. Upon becoming aware of the breach, CommSec initially determined that it was not significant to require notification to ASIC under section 912D of the Act. Pursuant to section 311 and section 990K of the Act, CommSec's auditors lodged a written report dated 20 September 2013 with ASIC, flagging the breach, the subject of this matter, as a reportable contravention. Accordingly, CommSec then notified ASIC of the breach on 20 September 2013.

27) This is the sixth occasion on which the MDP has found that CommSec has not complied with the market integrity rules, including a previous contravention of MIR 5.5.2 under MDP Infringement Notice MDP04/12 for which CommSec paid a penalty of $50,000. Since 2008, CommSec has also been sanctioned on three occasions by the ASX Disciplinary Tribunal for non-compliance with the ASX Market Rules.

28) ASIC also accepted an enforceable undertaking from CommSec on 17 December 2013 which related to concerns that ASIC held that CommSec may not have complied with its obligations in relation to the handling of client money under the Act. This enforceable undertaking was varied on 2 February 2015, to require CommSec to engage an independent expert to undertake ongoing reviews and provide monthly reports on the progress on a remediation plan developed under the original undertaking.

29) CommSec co-operated with ASIC throughout its investigation and did not dispute any material facts.

30) CommSec agreed not to contest the matter, thereby saving time and costs that would otherwise have been expended.

Compliance with the Infringement Notice

CommSec may choose not to comply with this infringement notice, but if CommSec does not comply, civil proceedings may be brought against CommSec in relation to the alleged contravention.

To comply with this infringement notice, CommSec must pay the penalty within the compliance period. The compliance period:

(a) starts on the day on which the infringement notice is given to CommSec; and

(b) ends 27 days after the day on which the infringement notice is given to CommSec;

unless an application is made for its extension.

CommSec may apply to ASIC for an extension of time to comply with this notice under regulation 7.2A.09 of the Regulations. If CommSec does so, and the application is granted, the compliance period ends at the end of the further period allowed.

If CommSec applies for a further period of time in which to comply with this notice, and the application is refused, the compliance period ends on the later of:

(a) 28 days after the day on which the infringement notice was given to CommSec; and

(b) 7 days after the notice of refusal is given to CommSec.

CommSec may apply to ASIC for withdrawal of this notice under regulation 7.2A.11 of the Regulations. If CommSec does so, and the application is refused, the compliance period ends 28 days after the notice of refusal is given to CommSec.

Effect of issue and compliance with the Infringement Notice

The effects of compliance with this infringement notice are:

(a) any liability of CommSec to the Commonwealth for the alleged contravention of subsection 798H(1) of the Act is discharged;

(b) no civil or criminal proceedings may be brought or continued by the Commonwealth against CommSec for the conduct specified in the infringement notice as being the conduct that made up the alleged contravention of subsection 798H(1) of the Act;

(c) no administrative action may be taken by ASIC under section 914A, 915B, 915C or 920A of the Act against CommSec for the conduct specified in the infringement notice as being the conduct that made up the alleged contravention of subsection 798H(1) of the Act;

(d) CommSec is not taken to have admitted guilt or liability in relation to the alleged contravention; and

(e) CommSec is not taken to have contravened subsection 798H(1) of the Act.

Publication

ASIC may publish details of this infringement notice under regulation 7.2A.15 of the Regulations.

Susan Humphreys
Counsel to the Markets Disciplinary Panel
with the authority of a Division of the Australian Securities & Investments Commission

Dated: 4 August 2016

Note: Members of the Markets Disciplinary Panel constitute a Division of ASIC as delegates of the members of the Division for the purposes of considering the allegations covered by this notice.

Appendix – Defined Terms

The terms defined in ASX MIR 1.4.3 have the same meaning when used in this notice, including:

"ASX" means ASX Limited (ACN 008 624 691).

"Market" means the market operated by the Market Operator under Australian Market Licence (Australian Stock Exchange Limited) 2002.

"Market Operating Rules" means the Operating Rules of the Market, other than the Market Listing Rules.

"Market Participant" means a participant in the Market admitted under the Market Operating Rules.

"Market Transaction" means a transaction for one or more Products, entered into on a Trading Platform or reported to the Market Operator under the Market Operating Rules.

"Order" means:
(a)   in relation to Cash Market Products, an instruction to purchase or sell Cash Market Products, or an instruction to amend or cancel a prior instruction to purchase or sell Cash Market Products; and
(b)   in relation to Derivatives Market Contracts, an instruction to enter into a Derivatives Market Transaction, or an instruction to amend or cancel a prior instruction to enter into a Derivatives Market Transaction.

"Products" means a Cash Market Product or a Derivatives Market Contract, as applicable.

"Rules" means these market integrity rules.

"Trading Messages" means those messages submitted into a Trading Platform relating to trading functions, such as Orders, amendment or cancellation of Orders and the reporting or cancellation of Market Transactions on the Trading Platform.

"Trading Participant" means a Market Participant which has Trading Permission in respect of one or more Products.

"Trading Platform" means a facility made available by the Market Operator to Trading Participants for the entry of Trading Messages, the matching of Orders, the advertisement of invitations to trade and the reporting of transactions.

The notice adopts the following additional definitions of terms:

"Relevant Period" means the period 2 August 2010 to 14 April 2013.

"SRN" means shareholder reference number.