

DISCIPLINARY MATTER – Commonwealth Securities Limited

Commonwealth Securities Limited ("CommSec") has paid a penalty of **\$300,000** to comply with an infringement notice given to it by the Markets Disciplinary Panel ("MDP"). The penalty was for CommSec:

- failing to have in place adequate organisational 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 respective Orders for the sale of those issuer sponsored holdings; and
- failing to ensure that such Orders did not interfere with the efficiency and integrity of the Market.

Background and circumstances

CommSec was alleged to have contravened subsection 798H(1) of the *Corporations Act 2001* ("Corporations Act") by reason of contravening Rule 5.5.2 of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 5.5.2").

MIR 5.5.2 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 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 Corporations 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 Corporations Act, by reason of contravening MIR 5.5.2, is \$1,000,000.

Pursuant to subsection 798K(2) of the Corporations Act, the maximum pecuniary penalty that may be imposed by the MDP and payable by CommSec under an infringement notice given

for contravening subsection 798H(1) of the Corporations Act, by reason of allegedly contravening MIR 5.5.2, is \$600,000.

Penalty under the Infringement Notice

The penalty payable under the infringement notice for the alleged contravention of subsection 798H(1) of the Corporations Act and therefore the penalty that CommSec paid to the Commonwealth, was **\$300,000**.

Relevant factors

In determining this matter and the appropriate pecuniary penalty to be applied, the MDP took into account all relevant guidance 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 where 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.

The Markets Disciplinary Panel

The MDP is a peer review body that exercises ASIC's power to issue infringement notices and accept enforceable undertakings in relation to alleged breaches of the market integrity rules. The market integrity rules are made by ASIC and apply to market operators, market participants and prescribed entities under the Corporations Regulations 2001 ("Regulations").

Additional regulatory information

Pursuant to subparagraphs 7.2A.15(4)(b)(i) and (ii) of the Regulations, CommSec has complied with the infringement notice, such compliance is not an admission of guilt or liability, and CommSec is not taken to have contravened subsection 798H(1) of the Corporations Act.

Further information on market integrity infringement notices, the market integrity rules or the MDP is available in ASIC Regulatory Guide 216–*Markets Disciplinary Panel* and ASIC Regulatory Guide 225–*Markets Disciplinary Panel practices and procedures* or at <http://www.asic.gov.au> under "markets–supervision", "markets–market integrity rules" and "Markets Disciplinary Panel".