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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Regulations 2001* administered by ASIC may have a right of review or may be entitled to have the infringement notice withdrawn.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, Darling Park 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 **$200,000**.

This infringement notice is given on 19 October 2016.

The unique code for this notice as required by paragraph 7.2A.06(b) of the Regulations is MDP6641/15.

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 contraventions and penalty

CommSec was a Market Participant in the Market operated by 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 Rules 2.1.3, 3.3.1(b) and 3.3.1(c) of the ASIC Market Integrity Rules (ASX Market) 2010 ("MIR 2.1.3", "MIR 3.3.1(b)" and "MIR 3.3.1(c)").

MIR 3.3.1(b) provides:

> *"A Market Participant must not enter into a Market Transaction for a Client, except in accordance with the instructions of the Client, or of a person authorised in writing by a Client to give such instructions, or pursuant to an exercise of discretion in respect of that particular Client's Managed*

Discretionary Account or as otherwise permitted by these Rules, the Competition Market Integrity Rules or the Market Operating Rules;"

MIR 3.3.1(c) provides:

"A Market Participant must not allocate a Market Transaction to a Client's account unless the Market Transaction was entered into on the instructions of the Client, or of a person authorised in writing by a Client to give such instructions, or pursuant to an exercise of discretion in respect of that particular Client's Managed Discretionary Account or as otherwise permitted by these Rules or the Market Operating Rules."

MIR 2.1.3 provides:

"A Market Participant must have appropriate supervisory policies and procedures to ensure compliance by the Market Participant and each person involved in its business as a Market Participant with these Rules, the Market Operating Rules and the Corporations Act."

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

MIR 3.3.1(b) – Market Participant restrictions to enter into Market Transactions

1) Between 25 March 2014 and 14 October 2014 ("Relevant Period"), CommSec entered into 59 Market Transactions ("Relevant Transactions") on behalf of a client ("Client"), in respect of two accounts held in the name of the Client, a 'Margin Loan Account' and an 'Equities Account' (together the "Client Accounts"), without the instructions of the Client who was deceased.

2) On 25 March 2014, CommSec received formal notification by way of death certificate that the Client was deceased. However, a Holder Record Lock was not applied to either of the Client Accounts.

3) The Relevant Transactions were subsequently entered into on the instructions of a family member ("Relevant Representative") of the Client through CommSec's online trading portal using the Client's online identification and passwords for the Client Accounts.

4) Although the Relevant Representative was authorised in relation to some matters related to trading on the Client's Margin Loan Account in the event of a margin call, the Relevant Representative was not authorised to provide instructions to enter into any of the Relevant Transactions on behalf of the Client.

MIR 3.3.1(c) – Market Participant restrictions to allocate Market Transactions

5) During the Relevant Period, CommSec allocated the Relevant Transactions to the Client Accounts without the instructions of the Client who was deceased.

6) The Relevant Transactions were entered into on the instructions of the Relevant Representative as specified in paragraphs 1 to 4 above. The Relevant Transactions were then allocated to the Client Accounts.

7) The Relevant Representative was not authorised to provide instructions on behalf of the Client to allocate the Relevant Transactions to the Client Accounts.

MIR 2.1.3 – Supervisory procedures

8) During the Relevant Period, the CommSec and CommSec Advisory Services deceased estate teams were in the process of undergoing a restructure ("Restructure").

9) On 7 October 2014, some of the Relevant Transactions were discovered when it was identified that a Holder Record Lock had not been placed on the Margin Loan Account. Subsequently on 8 October 2014, a Holder Record Lock was applied to the Margin Loan Account. However, a Holder Record Lock was not applied to the Equities Account, due to an apparent failure by CommSec to perform a search for any linked or related accounts, allowing further transactions to be executed on the Equities Account between 7 October and 14 October 2014.

10) On 23 October 2014, it was discovered that the Restructure had resulted in a backlog of deceased estate work involving failures to apply Holder Record Locks to a number of deceased accounts. In the course of addressing this backlog, it was identified that a Holder Record Lock had not been placed on the Equities Account. On 30 October 2014, CommSec suspended the Equities Account the effect of which prevented further Market Transactions from being executed. However, due to a breakdown in procedures, a Holder Record Lock was not applied on the Equities Account until 6 March 2015.

11) Accordingly, during the Relevant Period, the policies and procedures which CommSec had in place were insufficient to ensure compliance by CommSec with the ASIC Market Integrity Rules (ASX Market) 2010 and specifically with MIR 3.3.1(b) and MIR 3.3.1(c).

12) In particular, the policies and procedures to prevent unauthorised trading on deceased client accounts were insufficient in that, although written deceased estate policies and procedures existed:

    (a) CommSec did not ensure that these most fundamental procedures were properly implemented and integrated into the business or that compliance with them was appropriately monitored;

    (b) CommSec did not review these policies and procedures to ensure that they remained effective, particularly in light of the Restructure.

13) As a result, 52 deceased client accounts were at risk of unauthorised trading in that sufficient controls had not been placed on the accounts. Unauthorised trading occurred on a total of 59 occasions (the Relevant Transactions) in respect of two accounts (the Client Accounts).

14) On 7 November 2014, CommSec self-reported to ASIC potential contraventions of MIR 3.3.1 by way of a breach report.

By reason of CommSec having:

- entered into the Relevant Transactions on behalf of the Client, without the instructions of the Client who was deceased during the Relevant Period, the MDP has reasonable grounds to believe that CommSec contravened MIR 3.3.1(b) and thereby contravened subsection 798H(1) of the Act ("Contravention 1");
- allocated the Relevant Transactions to the Client Accounts without the instructions of the Client who was deceased during the Relevant Period, the MDP has reasonable grounds to believe that CommSec contravened MIR 3.3.1(c) and thereby contravened subsection 798H(1) of the Act ("Contravention 2");

- failed to have appropriate supervisory policies and procedures to ensure compliance with MIR 3.3.1(b) and MIR 3.3.1(c) during the Relevant Period, the MDP has reasonable grounds to believe that CommSec contravened MIR 2.1.3 and thereby contravened subsection 798H(1) of the Act ("Contravention 3").

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 3.3.1(b), is $1,000,000;
- by reason of contravening MIR 3.3.1(c), is $1,000,000;
- by reason of contravening MIR 2.1.3, 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:

- by reason of allegedly contravening MIR 3.3.1(b), is $600,000;
- by reason of allegedly contravening MIR 3.3.1(c), is $600,000;
- by reason of allegedly contravening MIR 2.1.3, is $600,000.

Penalty under the Infringement Notice

The penalties imposed by the MDP for the three alleged contraventions of subsection 798H(1) of the Act the subject of this matter, are as follows:

- Contravention 1 – MIR 3.3.1(b) – $30,000;
- Contravention 2 – MIR 3.3.1(c) – $30,000;
- Contravention 3 – MIR 2.1.3 – $200,000.

However, the MDP considered it appropriate in this matter to adjust the total sum of the separate penalties as set out above, to ensure that the final penalty payable was just and appropriate and not excessive, having regard to the totality of the conduct and other relevant factors. In doing so, the MDP had regard to paragraphs RG 216.125 and RG 216.126 of ASIC Regulatory Guide 216–*Markets Disciplinary Panel* ("RG 216") and applied the totality principle in arriving at the appropriate pecuniary penalty to apply in this matter.

On this basis, and in accordance with subparagraphs 7.2A.06(g)(i) and (ii) and subregulation 7.2A.07(2) of the Regulations, for the three alleged contraventions of subsection 798H(1) of the Act the subject of this matter, the MDP imposed a total pecuniary penalty of $200,000, as follows:

- Contravention 1 – MIR 3.3.1(b) – $23,500;
- Contravention 2 – MIR 3.3.1(c) – $23,500;
- Contravention 3 – MIR 2.1.3 – $153,000.

Therefore, the total penalty that CommSec must pay to the Commonwealth is **$200,000**, being the total penalty payable under this infringement notice for the three alleged contraventions of subsection 798H(1) of the Act.

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 penalty to be applied, the MDP took into account all relevant guidance, including RG 216, and noted in particular the following:

15) That the remedies applied should:

- promote market integrity along with confident and informed participation of investors in financial markets;
- act as a deterrent to any future misconduct by the subject person; and
- also act as a general deterrent to others from engaging in the same or similar conduct;

16) MIR 2.1.3 is aimed at promoting confidence in the integrity of the market. Imposing a strict obligation on Market Participants to have appropriate supervisory policies and procedures to ensure compliance with the market integrity rules is critical in maintaining the integrity of the market. This includes:

- fully implementing supervisory policies and procedures;
- monitoring and reporting on compliance with supervisory policies and procedures;
- regularly reviewing the effectiveness of supervisory policies and procedures, ensuring that they are kept up to date, remain functional and in place at all times; and
- ensuring that supervisory policies and procedures are reviewed when there are changes to the business e.g., business unit restructures, consolidations etc. This includes having robust and effective processes and controls for identifying changes that may impact on the effectiveness of supervisory policies and procedures;

17) CommSec failed to ensure that during the Relevant Period it had in place appropriate supervisory policies and procedures to ensure compliance with MIR 3.3.1(b) and MIR 3.3.1(c). Of considerable concern to the MDP was the effect of the Restructure and the apparent failure to address the Restructure's implications on the relevant supervisory policies and procedures supporting the critical back office functions for the management of deceased estates and compliance with MIR 3.3.1. In the MDP's view, the implementation of any business change which may impact on the ability of a Market Participant to continue to meet its regulatory obligations, requires the exercise of great caution and diligence;

18) MIR 3.3.1 is similarly aimed at promoting confidence in the integrity of the market with client or investor protection being of primary importance. Imposing a strict obligation on Market Participants to protect clients from unauthorised trading is therefore also critical in maintaining the integrity of the market;

19) The misconduct was of a serious nature as it had the potential to undermine confidence in the integrity of the market;

20) All three alleged contraventions of the market integrity rules the subject of this matter arose from a single course of conduct;

21) The misconduct giving rise to the three alleged contraventions was reckless on the part of CommSec. CommSec did not take sufficient care to ensure that it took into account the effect of the business change or Restructure on its supervisory policies and procedures to ensure compliance with the market integrity rules; nor to ensure that it implemented and monitored compliance with its supervisory policies and procedures to prevent unauthorised trading on the Client Accounts;

22) The misconduct was reckless as it transpired over a period of several months;

23) CommSec did not appear to have caused detriment as a result of the alleged contraventions, given the Relevant Transactions resulted in no net loss. Notwithstanding this, the potential to cause detriment was real and apparent given a total of 52 client accounts were left at risk of unauthorised trading during the Relevant Period;

24) Whilst the initial self-report to ASIC was provided in a timely manner, CommSec was only able to provide a more accurate indication of the extent of the issues after conducting a comprehensive investigation;

25) Upon identification of the misconduct, CommSec promptly undertook steps to prevent any recurrence of the contraventions including:

- reviewing its supervisory policies and procedures to ensure compliance with the market integrity rules;
- introducing regular compliance and risk reviews to test the robustness of its supervisory policies and procedures;
- updating its supervisory policies and procedures to account for business changes particularly by analysing existing controls and introducing additional controls to ensure deceased estate accounts are actioned appropriately on a timely basis;
- instigating training and education programs for frontline staff, their team leaders and back office;
- allocating extra resources to finalise the backlog of deceased estate client accounts; and
- initiating a comprehensive review of its deceased client accounts for the period December 2010 to April 2014 (with no other unauthorised trading being detected);

26) Whilst it was a Commsec procedure that upon notification of the death of a customer the customer's account/s was to be suspended pending a HIN Lock being applied by the ASX this did not take place in two accounts which resulted in 59 trades taking place after notification of death had been received;

27) The misconduct did not:

- result in any client detriment, complaints or claims of fraud; or
- involve any dishonesty on behalf of CommSec;

28) This is the seventh occasion on which the MDP has found that CommSec has not complied with the market integrity rules. Since 2008, CommSec has also been sanctioned on three

occasions by the ASX Disciplinary Tribunal for non-compliance with the ASX Market Rules and on one occasion before ASX Compliance for non-compliance with the ASX Settlement Operating Rules;

29) 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;

30) The MDP emphasises that any repeat contraventions in similar or comparable circumstances will not be viewed favourably, and in accordance with Section E of RG 216, may result in the imposition of substantially higher pecuniary penalties and/or other remedies;

31) CommSec co-operated with ASIC throughout ASIC's investigation and did not dispute any material facts; and

32) 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 contraventions.

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 infringement 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 infringement 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 infringement 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 contraventions of subsection 798H(1) of the Act are 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 contraventions 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 contraventions of subsection 798H(1) of the Act;

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

Grant Moodie
Special Counsel to the Markets Disciplinary Panel
with the authority of a Division of the Australian Securities & Investments Commission

Dated: 19 October 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 MIR 1.4.3 have the same meaning when used in this notice, including:

"ASX" means ASX Limited (ACN 008 0624 691).

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

"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.

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

This notice adopts the following additional definitions of terms:

"Holder Record Lock" has the meaning given by section 2 of the ASX Settlement Operating Rules.