

Commonwealth Securities Limited

Enforceable Undertaking
Independent Expert Summary Report

25 January 2017

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Limitations

This Summary Report is prepared to provide a high level summary of our work carried out as the Independent Expert at the request of Commonwealth Securities Limited, the Australian Investment Exchange Ltd (AUSIEX) and the Australian Securities & Investments Commission solely for the purpose set out in Section 1 of this report.

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1. Background and scope

1.1 Context of the Enforceable Undertaking

Between 15 July 2010 and 11 October 2013, Commonwealth Securities Limited (Commsec) and the Australian Investment Exchange Ltd (AUSIEX), collectively referred to as Commonwealth Securities Group (CSG), reported to the Australian Securities and Investments Commission (ASIC) matters relating to the handling of Client Money. Compliance incidents were self-identified through CSG's internal procedures and reported to ASIC in line with their compliance processes. These incidents arose out of processing Client Money inconsistently with the Client Money Requirements.

In February 2012 CSG undertook an internal review to ensure that regulations and internal policy requirements were being met. This formed the basis for the development of the scope for the Trust Account Remediation Program (TARP). The program was completed in December 2012.

CSG continued to report matters relating to the handling of client money following completion of the TARP.

CSG entered into an Enforceable Undertaking (EU) with ASIC on 17 December 2013.

1.2 Scope of our review

EY was appointed on 11 February 2014 as the Independent Expert under the EU. The scope of our review included:

1. Validation of CSG's Trust Account Remediation Program

This included an assessment of the design and operating effectiveness of the controls, systems and processes implemented under TARP to address the causes of the compliance incidents.

2. An assessment of CSG's current controls, systems and processes in place as they relate to client money requirements

This included an independent assessment as to whether CSG's current controls, systems and processes are adequate to maintain ongoing compliance with client money requirements, consistent with relevant AFSL conditions and in accordance with the Corporations Act.

On 10 June 2014 we reported our findings in relation to the effectiveness of controls, systems and processes implemented under CSG's Trust Account Remediation Program (TARP) to prevent breaches of Client Money Requirements.

As a result of subsequent discussions between ASIC and CSG, a variation to the EU was agreed on 11 December 2014 which required CSG to undertake further work satisfactory completion of which would be assessed by EY.

Under this variation, EY was engaged to assess the design and operating effectiveness of controls, systems and processes implemented by CSG under their Remediation Plan dated 19 September 2014. The Remediation Plan sought to address the recommendations and findings of the 10 June 2014 Report.

EY issued its Final Report in relation to the EU on 4 September 2015.

1.3 Summary Report

This report has been prepared to summarise the outcomes of our Independent Review, which was finalised on 24 August 2015.

We have not considered any events that occurred after that date.

2. Findings and Observations

Our review completed in June 2014 identified and reported six key findings, which are summarised in the table below.

CSG developed a Remediation Plan dated 19 September 2014 detailing an Action Plan and timeframes to address our recommendations.

EY subsequently assessed the design and operating effectiveness of controls, systems and processes implemented by CSG under their Remediation Plan. We assessed controls at the earlier of one month after implementation of relevant controls or after an appropriate period of embedding (as applicable per the nature and performance frequency of the control).

Our assessment was completed over the period 17 November 2014 to 4 September 2015.

Below is an overview of our observations from our 10 June 2014 Report and remediation that CSG subsequently completed.

June 2014 Report Findings	Finding Summary	CSG's Remediation Response
1. Payment approach for certain funds in and out of bank accounts may increase client money risks	We found funds received were not treated consistently across different account types and sources, including receipt methods and distribution channels.	CSG amended its process for treating equivalent funds to ensure it was consistent across all account types and sources.
2. Design deficiencies regarding the completion of trust account reconciliations present compliance risks	We found that, while CSG was appropriately holding unidentified monies in Trust, these monies were not being treated as unreconciled items and subject to the reconciliation monitoring and escalation processes.	CSG improved its protocols for the handling of these unidentified monies and implemented daily monitoring procedures to support the protocols, with appropriate preparer and reviewer sign-offs.
3. Client money handling procedures do not consider fund transfers between other licensees	We found the process used to identify all administrative and agent arrangements within the CBA group was not sufficiently robust and there was potential that all arrangements were not being considered. Further, transaction descriptions for payments made to other licensees did not include sufficient details to notify the recipient whether the funds were Client Monies.	CSG conducted a top-down completeness review of administrative and agent arrangements within the broader CBA Group. Subsequently variations were made to agreements to comply with client money obligations, as required. Further, the payments process and corresponding controls were amended to include 'Client Money' or 'CM' within the relevant transaction descriptions.

June 2014 Report Findings	Finding Summary	CSG's Remediation Response
4. Improvements to effective performance of controls assurance programs are required	<p>In assessing the effectiveness of the enhanced Controls Assurance Process (CAP), we found the testing program was incomplete for new controls implemented, failure tolerances were not defined and sampling approaches did not appropriately consider the nature and frequency of controls.</p> <p>Additionally, it was noted that the understanding of client money obligations by independent testers required uplift which had resulted in poor documentation of work performed and conclusions and minimal levels of professional scepticism being applied.</p>	CSG implemented mandatory client money training for all independent testers and updated its CAP program for completeness and improved test plans and guidance to provide further clarity and guidance to the testers.
5. Assessment of client money handling risks and controls do not include an assessment of third parties	We found the process for identifying third parties which had impacts on Client money was being inconsistently performed. Further, the initial risk assessment and subsequent annual reviews required improvement.	CSG implemented additional onboarding protocols for assessing the impacts of third parties on client money obligations, including standardising the approach for assessing the vendors risk management processes.
6. Client Money Requirements are still maturing and consideration should be given to secondary processes impacting client monies	<p>Further improvements were identified to ensure Client Money Requirements were being appropriately considered during business changes or key events. For example, new business or client acquisitions, new products and major technology changes.</p> <p>Additionally, there are processes not directly related to client money handling activities where client money risks and related controls should be tested. For example, product approval and maintenance, branch/cheque payments and cancellations and client fee structures and maintenance.</p>	<p>CSG's documented client money protocols and procedures were improved to more adequately consider business changes. The scope of CSG's controls assurance program was also extended to include ongoing validation of the currency and coverage of these protocols and procedures.</p> <p>Indirect and secondary processes to client money processes were identified and assessed for flow on impacts from other remediation activities. Protocols for these processes were updated to reflect consideration of client money impacts as a result of direct process changes.</p>

Based on our work we found CSG's implementation of the Remediation Plan had successfully addressed the recommendations in our June 2014 report.

As at 24 August 2015 we found:

- ▶ CSG's implementation of the Remediation Plan had addressed the recommendations in our June 2014 report
- ▶ Controls, systems and processes implemented under the Remediation Plan were assessed as effective

- ▶ Given the recent implementation of many control improvements, coupled with the required commensurate uplift in control awareness, it was necessary for CSG to:
 - a. Continue strengthening staff's control awareness, including professional scepticism, as it relates to client money controls, and
 - b. Ensure that as the control environment transitioned from a Project to business-as-usual environment the operating model was demonstrably sustainable.

To ensure the ongoing sustainability and effectiveness of its control environment, CSG committed to:

- ▶ Establishing control effectiveness reporting dashboards to be presented at the monthly CSG Risk Governance forums
- ▶ Implementing quarterly reporting to the CSG Board on control effectiveness
- ▶ Continuing to escalate compliance incidents relevant to client money handling to stakeholders within the CSG executive management team
- ▶ Engaging Internal Audit to perform an end-to-end maturity review of the controls, systems and processes implemented as part of the EU

EY has not performed any subsequent validation of these activities.

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