Jessica Zhang

From: Jennet Butler <jennet.butler@rbsmorgans.com>
Sent: Monday, 26 August 2013 5:14 PM
To: David DeCarli
Cc: Brian Sheahan; Hamish Dee; William McNickle
Subject: RBSM options business
Attachments: s 22 [redacted]

***
This email message has been processed by MIMEsweeper
***

Dear David

We refer to your email of 2 August 2013 and RBSM's response to the issues identified. ASIC acknowledge RBSM's pro-active response in relation to the ex-Burleigh Heads operation but is mindful, given the serious and likely extended level of Corporations Act contraventions identified, that a more extensive group-wide RBSM response may be required and reserves all rights in this regard.

RBSM acknowledges ASIC's reservation of rights but believes that a more extensive group-wide RBSM response is not required. There are no other branches in the RBSM network which are similar to the Burleigh office in terms of business model. The majority of branches with clients who utilise options are doing so as protection for the portfolio; a way of purchasing stock more cheaply with an emphasis on having the cash to take up positions; or as a means of generating additional income through buy/write and covered calls.

By way of example using our 31 March YE audited returns, in the 12 months to 31/03/2012, the Burleigh office generated options revenue of $3,164,067 through 3 derivatives advisers (Peters, Froggatt and Burton) versus total revenue for the branch of $4,183,109. Thus the options revenue was 75.6% of the total revenue for the whole branch. To put this in perspective, the other 56 branches had combined options revenue of $6,830,343. So of the total options revenue for the RBSM group for YE 31/03/2012 of $9,994,410, the Burleigh options revenue was 32% of the total.

For the 12 months to 31/03/2013 (excluding the Burleigh options revenue generated for the 2 months of that year they were with us of $148,531), the total options revenue for the RBSM group was $6,086,639.

The extent of the involvement in each of the RBSM branches with options has been detailed in the **attached** spreadsheet. 5 branches have no derivatives accredited ARs. We have detailed for each branch with derivatives accredited ARs the following:

- Total number of authorised representatives (ARs) for that branch.
- Number of ARs with ADA1 and ADA2.
- Percentage of ARs in each office that have ADA competencies
- The number of ARs who are actually using the competency and have clients who are using derivatives (we note that a number of our ARs have the competency but have no intention of using options or recommending them to their clients)
- The total options revenue ($) YTD 31/03/13 (audited figures)
- Options revenue as a percentage of total revenue for the branch (%) YTD 31/03/13 (audited figures)

For branches who have greater than 15% of the branch revenue derived from options, we have provided a comment about the business model or type of clients that are using options in that branch.

We have also attached an updated spreadsheet from the one provided at our meeting of 11 July 2013 which adds the June and July 2013 option figures. As can been seen from the **attached** spreadsheet, the options revenue as a % of total revenue has decreased from 6% in September 2011 to 2.2% in July 2013.

As you are aware, there have been substantive changes to the way we operate and supervise the options business. These have been discussed in our various meetings and in our responses. This is not a part of the business that we are looking to grow or develop. For example, we recently refused to issue an AR to a potential derivatives employee of one of our branches due to concerns relating to the history of the individual. We also refused a large options

business writer from another firm due to his clients open option positions falling outside our Derivatives Policy.

All new option accounts are now vetted by the Derivatives Risk Committee (DRC) prior to opening to ensure options are an appropriate investment for these clients. We have also reviewed the option accounts and identified 1,602 active options accounts that had not traded in the past 12 months. After review we sent out 40 client option questionnaires, keeping 158 accounts as active and deactivating 1,272. We are still waiting to hear from 132 accounts. Since 1 January 2012 we have deactivated a total of 3,600 option accounts.

The DRC is reviewing exception reports and the 20% down stress test every morning from 9.15am for 15 to 30 minutes to resolve issues relating to derivatives (options and warrants). Focus items are the 20% down stress test; large brokerage advisers / accounts; late settling clients; SMSF's. Where the DRC feels there is an issue or a matter worth further investigation in relation to an account or adviser, compliance review the account and we invite the adviser to attend the DRC meeting to discuss the account. The meetings are all formal and minuted.

Our Director, Equity Derivatives has spoken to or met with the top 10 clients on our 20% down stress test to gauge their understanding and appropriateness of options usage for their accounts. We continue to focus on the 20% down stress test at the DRC for a number of reasons:

- the volatility in the market is historically very low and the fact that the majority of our clients are selling positions to open, we believe it is prudent for us, our advisers and our clients to be prepared for a sharp increase in volatility and be prepared for a higher level of volatility;
- our balance sheet requirements following RBS exist of ownership and cash equity margining are leading to a smaller capacity for our balance sheet to support risky positions; and
- we are educating clients via advisers that clients should consider their business continuity risk and that 20% is a reasonable figure to use (market makers use 15%), but we are constantly monitoring exposure with reduced transaction costs.

We continue to expand on the educational material on our website and a website reference is included on the overnight reports to clients. Head office is also now emailing the ASX Understanding Options booklet and PDS to all new option clients with contact details for our Director, Equity Derivatives.

We continue to audit all advisers in the RBSM network as part of business as usual, and option advisers are reviewed more often to ensure we are comfortable with the advice being provided and that it is appropriate to individual client circumstances. While the focus of our current round of compliance audits is FOFA compliance and SMSF's, for option advisers, we will be using the Acompli client review sheets to audit the option accounts.

We trust that this provides you with the information that you need but we are happy to provide any further information you require or come to Sydney and meet with any other ASIC personnel to further discuss our former Burleigh office or our options business.

Regards

Jennet Butler
Director, Legal & Compliance

RBS Morgans Limited | ABN 49 010 669 726 | AFSL 235410

Level 29, 123 Eagle St, Brisbane QLD 4000
Direct: 07 3334 4536 | Mobile: 0418 142 460 | Fax: 07 3834 0536
Email: jennet.butler@rbsmorgans.com
Web: www.rbsmorgans.com

RBS Morgans

smartinvestor Blue Ribbon Awards 2013 WINNER FULL SERVICE BROKER OF THE YEAR

This email message is confidential and may be privileged. Unauthorised use, copying or distribution of any part of this email including attachments is prohibited. If you are not the intended recipient please forward the email to info@rbsmorgans.com and delete the original.

RBS Morgans Limited and its associates may hold securities in the companies/trusts mentioned herein. Unless otherwise stated any advice contained in this email is of a general nature only and has been prepared without taking into account your relevant personal circumstances. Those acting upon information contained in this email without first consulting one of RBS Morgans' investment advisers do so entirely at their own risk.

To the extent permitted by law we exclude (and where the law does not permit exclusion, limit to the extent permitted by law) all liability for any direct, indirect and consequential losses, damages and expenses incurred in any way (including but not limited to that arising from negligence), connected with any use or access to or any reliance on information contained in this email or any attachments.

RBS Morgans Limited (ABN 49 010 669 726 AFSL 235410) A Participant of ASX Group Professional Partner of the Financial Planning Association of Australia

To unsubscribe from this email please forward this email to unsubscribe@rbsmorgans.com