ASX Disciplinary Matter – Morrison Securities Pty Ltd

ASX's Chief Compliance Officer (the '**CCO**') has determined that Morrison Securities Pty Ltd ('**Morrison'**) did not comply with:

(a) ASX Clear Operating Rule ("**ASX CR**") 4.23.2, being its obligation to hold in trust money in relation to Market Transactions to which Division 2 of Part 7.8 of the Corporations Act 2001 (Cth) ("**Corporations Act**") applies;

(b) ASX CR 4.24.1, being the prohibition on withdrawing from its clients' trust account money received in connection with a client purchase of financial products until it has taken steps for the financial products to be registered in the name of the client;

(c) ASX CR 4.23.6, being the obligation to perform a reconciliation, in the time, form and manner set out in the related procedure that is accurate in all respects, of balances held in its clients' trust accounts and the corresponding balances as recorded in its accounting records; and

(d) ASX CR 4.1.1(a), being its obligation to at all times continue to satisfy the admission requirements in ASX CR 3.2.1(e) and 3.5.1 to have adequate processes to comply with its obligations under the ASX CRs.

Seven contraventions of these ASX CRs arose from two events, being two separate contraventions of each of ASX CRs 4.23.2, 4.24.1 and 4.23.6 arising from each of the two events, and a single contravention of ASX CR 4.1.1(a) arising across the two events (together, the '**Contraventions**').

The CCO imposed a total fine of $80,000 (plus GST) for the Contraventions, consisting of:

(a) $50,000 (plus GST) in relation to the Contraventions relating to event 1; and

(b) $30,000 (plus GST) in relation to the Contraventions relating to event 2.

In this Notice, references to "ASX" are to the relevant ASX licensee as the context requires.

<u>The circumstances of this matter are</u>:

Summary

The Contraventions relate to two events which arose in respect of a direct debit facility established by Morrison when it starting clearing and settling trades for D2MX clients in late August 2018.

Event 1 persisted for over 2 and a half months (28 August 2018 and 20 November 2018) and relates to Morrison using other client monies to meet settlement obligations in connection with purchase transactions for direct debit clients where a portion of these direct debit funds were uncleared. This arose because under the direct debit facility, debits would take up to 3 days to clear, however the accounting system used by Morrison would treat the direct debit funds as cleared and available to be used immediately for the purposes of settlement, resulting in the payment of other clients' monies out of Morrison's trust accounts to Morrison's general account.

Event 2 persisted for over one month (30 August 2018 to 10 October 2018) and relates to Morrison using other client monies to meet dishonoured direct debit payments. On each occasion, such shortfall was generally rectified by Morrison one day after such use.

Further detail on these events and the related contraventions is set out below.

Background

In 2018, Morrison was bought by the Sequoia Group to clear and settle trades executed by Sequoia Group's wholly owned group entity and ASX market participant, D2MX Pty Limited ("**D2MX"**). This resulted in a material change to Morrison's business including clearing and settlement services in respect of D2MX clients being migrated to Morrison effective 28 August 2018 (the "**Migration**").

For the purposes of ASX CR 4.23.3, Morrison operated the following trust accounts:

(a) An existing trust account, used as the primary account for holding client money on trust ("**Existing Trust Account**"); and

(b) A new trust account established to receive direct debit funds from clients for settlement ("**New Trust Account**").

The New Trust Account became operational on 28 August 2018 to provide the ability for Morrison's post-Migration client base to settle trades through a direct debit facility. Prior to the Migration, Morrison only accepted monies from clients for the settlement of their trades through its cash management account or the transfer of funds directly into the Existing Trust Account via either a BPAY or electronic funds transfer.

For direct debit clients who had executed purchase transactions, direct debits were processed for the transfer of funds to meet settlement obligations on those transactions from the client's bank account to the New Trust Account. On a daily basis, funds are then swept from the New Trust Account to the Existing Trust Account to meet settlement obligations on purchase transactions by those direct debit clients.

Settlement of client purchase transactions in batch settlement was funded by Morrison from its Existing General Account (referred to as "**General**" or "**House**" account).

Where on a day Morrison has an entitlement to receive monies from its trust account on account of settlement obligations in connection with client purchase transactions that it funded in batch settlement, this was paid to its General account from the Existing Trust Account as part of its daily trust funding movement at the end of each day.

Event 1

Between 28 August 2018 and 20 November 2018 (the "**Relevant Period for Uncleared Payments**"), Morrison withdrew out of its client money trust accounts funds to meet settlement obligations in connection with client purchase transactions by direct debit clients, where a portion of those funds were uncleared and therefore not available to meet such obligations.

Morrison indicated that a contributing factor to the withdrawals was how direct debits were cleared by the bank providing the New Trust Account and how those direct debit amounts were reflected in the accounting system used by Morrison for recording and reconciling all client securities transactions and movements to and from its trust account, with:

(a) The direct debit facility offered by the bank providing the New Trust Account (and linked to the New Trust Account) not being a same day facility and requiring the funds to be cleared before they are available to Morrison (this may have taken 3 days to clear funds (or 2 days to dishonour)).

(b) Even though the funds were uncleared, the accounting system used by Morrison would treat the direct debit client funds as cleared and available to be used immediately for the purposes of settlement.

(c) The accounting system trust movement report relied upon as the basis for transferring funds out of the New Trust Account included uncleared funds from the direct debit facility.

Direct debits would generally be processed for the transfer of funds from the client's bank account to the New Trust Account on the first day or second day after the client purchase transaction to which those funds relate (i.e. "T+1" or "T+2", where "T" is the date of the client purchase transaction).

In respect of clients who met their settlement obligations through the direct debit facility, funds may not be cleared until:

(a) for direct debits processed on T+1: up to four days after the relevant purchase transaction(s) occurred, i.e. "T+4"; or

(b) for direct debits processed on T+2: five days after the relevant purchase transaction(s) occurred, i.e."T+5".

This meant that when withdrawing monies from the Existing Trust Account (in respect of funds swept from the New Trust Account to the Existing Trust Account) to meet settlement obligations in connection with purchase transactions of direct debit clients (generally on the second Business Day after the date of the transaction, i.e. "T+2"), other clients' cleared funds held on trust were used to meet the settlement obligations of those direct debit clients.

While it wasn't feasible to obtain an accurate representation of the exact client money amounts withdrawn from trust that were attributable to a trust deficiency, details provided by Morrison indicated that the potential aggregate deficiencies in the trust account for each Business Day in the period 28 August 2018 to 20 November 2018, ranged from $34,838.02 to $2,480,646.37 (covering direct debit batches processed over a three day period and direct debit dishonours on that day), with the total amount of direct debit batches processed during the period 28 August 2018 to 20 November 2018 being $25,239,068.98.

Based on the information provided, ASX anticipates that:

(a) a portion of the total direct debit amounts referred to above would form an unauthorised withdrawal from trust;

(b) this portion for each Business Day would vary across the period;

(c) the aggregate amounts for each Business Day and total amount during the period referred to above is indicative of the potential scale of the breach on a day as well as across the period.

Reconciliations during Event 1

Reconciliations performed for business days during the Relevant Period for Uncleared Payments used balances derived from the accounting system that were overstated given that the GBST system would treat the direct debit payments as cleared and available to be used immediately upon the direct debit being processed (notwithstanding that such transfers could take up to 3 days to clear).

The reconciliations did not account however for differences in balances in the bank statements for the New Trust Account and balances in the accounting system by categorising them as "items in ledger not in the trust bank account statement".

Event 2

Between 30 August 2018 and 10 October 2018 (the "**Relevant Period for Dishonoured Payments**"), the New Trust Account was debited in the event of a dishonoured direct debit payment.

The direct debit facility offered by the bank providing the New Trust Account may have taken 2 days to dishonour a direct debit payment after the processing of that payment from the client's bank account to the New Trust Account, usually occurring four days after the transaction to which the direct debit relates, i.e. "T+4".

In the case of a dishonoured direct debit payment, the New Trust Account would be debited by an equivalent amount to the dishonoured payment.

Accordingly, cleared funds in the New Trust Account that were attributed to other clients were being used to meet the dishonoured direct debit payments.

Morrison indicated that a contributing factor to the breach was that, despite several follow-ups, the bank providing the New Trust Account did not reflect until 11 October 2018 instructions from Morrison provided since August 2018 when the direct debit facility was made available to clients to settle transactions, to apply all dishonours to the General account.

The total dishonoured direct debit payments deducted from the New Trust Account in the period 28 August 2018 to 10 October 2018, ranged from $220 to $201,713.33 for each day, with the total dishonoured direct debit payments deducted from the New Trust Account being $1,266,968.24 during that period.

Such deficiency in the trust account was rectified generally 1 day after the deduction for a dishonoured direct debit payment occurred.

Reconciliations during Event 2

Where a deduction from the New Trust Account for a dishonoured direct debit payment occurred this was identified in the bank statements for the New Trust Account but was not reflected in the balances derived from the accouting system (which assumed that uncleared funds in respect of the direct debit payments which were dishonoured were already in the client trust account).

The reconciliations for business days during the Relevant Period for Dishonoured Payments after a deduction from the New Trust Account for a dishonoured direct debit payment had occurred and before such deficiency was rectified, did not however account for differences in balances in the bank statements for the New Trust Account and balances in the accounting system as "items on trust bank account statement not in ledger".

Contravention 1

Event 1 represents a breach of **ASX CR 4.23.2**, which requires client money received in relation to market transactions to be held in trust at all times unless a permitted withdrawal applies under s981C of the Corporations Act and Regulation 7.8.02 of the Corporations Regulations.

Morrison's use of other clients' money in the New Trust Account and the Existing Trust Account to meet settlement obligations of direct debit clients whose payments were yet to be cleared and received into the New Trust Account was not a permitted withdrawal of client money from trust and resulted in deficiencies in the trust account occurring on each business day for the duration of the Relevant Period for Uncleared Payments.

Contravention 2

Event 2 represents a breach of **ASX CR 4.23.2**, which requires client money received in relation to market transactions to be held in trust at all times unless a permitted withdrawal applies under s981C of the Corporations Act and Regulation 7.8.02 of the Corporations Regulations.

Morrison's use of other clients' money in the New Trust Account to meet dishonoured payments of direct debit clients to the New Trust Account was not a permitted withdrawal of client money from trust and resulted in deficiencies in the trust account occurring on and from the day of such use during the Relevant Period for Dishonoured Payments until such deficiency was rectified, generally one day after such use.

This is contrary to the expectation in ASX CR Guidance Note 12 that a participant should make appropriate arrangements with its bank to ensure that dishonours are not debited to its trust account (refer to section 7).

Contravention 3

Event 1 represents a breach of **ASX CR 4.24.1** which prohibits withdrawals from a client trust account for monies received by Morrison in connection with the purchase of Financial Products under a Cash Market Transaction unless all steps required under ASX CR 4.24.1 have been taken in order for the relevant Financial Products to be registered or held in the name of the buying client (or such other person instructed by them) or another permitted withdrawal applies under ASX CR 4.24.2.

Morrison's use of other clients' money in the New Trust Account and the Existing Trust Account, which was received in respect of purchase transactions, to meet settlement obligations of direct debit clients whose payments were yet to be cleared and received into the New Trust Account had not involved the taking of such steps under ASX CR 4.24.1 and was not otherwise a permitted withdrawal of client money from trust under ASX CR 4.24.2.

Contravention 4

Event 2 represents a breach of **ASX CR 4.24.1** which prohibits withdrawals from a client trust account for monies received by Morrison in connection with the purchase of Financial Products under a Cash Market Transaction unless all steps required under ASX CR 4.24.1 are taken in order for the relevant Financial Products to be registered or held in the name of the buying client (or such other person instructed by them) or another permitted withdrawal applies under ASX CR 4.24.2.

Morrison's use of other clients' money in the New Trust Account and the Existing Trust Account, which was received in respect of purchase transactions, to meet dishonoured direct debit payments of direct debit clients to the New Trust Account had not involved the taking of such steps under ASX CR 4.24.1 and was not otherwise a permitted withdrawal of client money from trust under ASX CR 4.24.2.

Contravention 5

Event 1 represent a breach of **ASX CR 4.23.6** as any reconciliations performed by Morrison for the duration of the Relevant Period for Uncleared Payments, between balances in its clients trust accounts and the corresponding balance as recorded in its accounting records, could not be classified as being "accurate in all respects".

Notwithstanding the difference in balances between the New Trust Account and the accounting system arising from the balances derived from the acounting system being overstated with uncleared funds, these reconciliations did not properly account for them by failing to identify such differences as "items in ledger not in trust bank account statement" and including a description of such items.

This is contrary to the expectation in ASX CR Guidance Note 12 that such differences between the two balances are to be listed and categorised as "items in ledger not in trust bank account statement" (refer to section 7).

Contravention 6

Event 2 represents a breach of **ASX CR 4.23.6** as reconciliations performed by Morrison on the days during the Relevant Period for Dishonoured Payments when a deduction from the New Trust Account for a dishonoured direct debit payment had occurred and before that deficiency was rectified (generally one day later), between balances in its clients trust accounts and the corresponding balance as recorded in its accounting records, could not be classified as being "accurate in all respects".

Notwithstanding differences in balances between the New Trust Account and the accounting system arising from the dishonoured direct debit payments not being reflected in the accounting system, these reconciliations did not properly account for them by failing to identify the direct debit dishonours as "items on trust bank account statement not in ledger" and including a description of such items.

This is contrary to the expectation in ASX CR Guidance Note 12 that such differences between the two balances are to be listed and categorised as "items on trust bank account statement not in ledger" and a description of those items being included for each individual item (refer to section 7).

Contravention 7

Events 1 and 2 represent a breach of **ASX CR 4.1.1(a)**, being Morrison's obligation to at all times (including during the Relevant Period for Uncleared Payments and the Relevant Period for Dishonoured Payments (respectively)) continue to satisfy the admission requirements in ASX CR 3.2.1(e) and 3.5.1 to have adequate processes to comply with its obligations under the ASX CRs.

Morrison did not demonstrate that it had adequate processes in place to ensure its ongoing compliance with the client money requirements in the ASX CR, including in:

(a) Morrison not understanding how its newly established direct debit processing to its New Trust Account would interact with its accounting system following the migration of D2MX clients;

(b) ASX guidance identifying processes to comply with client money requirements as 'key processes' which a participant is expected to have documented and be satisfied on; and

(c) Morrison's failure to detect deficiencies in trust through the client account reconciliation process for an extended period (being over two and a half months in respect of the circumstances in Event 1),

and is below the standard ASX expects clearing participants to have in place to comply with the client money obligations.

<u>In determining the penalty, the CCO, among other factors, took into account the following:</u>

(a) With respect to the factors in determining sanctions that relate to the seriousness of a contravention, as set out in Annexure A to the Enforcement and Appeals Rulebook Procedures, refer to paragraphs (b) to (g) below;

(b) The Contraventions could have materially impacted on:

    i. ASX's compliance with the Reserve Bank of Australia's (**RBA**'s) financial stability standards (**FSS**) for central counterparties which apply in relation to the clearing and settlement facility operated by ASX; or

    ii. the reputation of ASX or the clearing and settlement facility it operates.

(c) The client money provisions in the Corporations Act and the ASX CR (together with client money provisions in the ASIC Market Integrity Rules) protect the interests of clients receiving financial products and services from ASX participants. This includes by separating certain money received from clients from money belonging to participants, imposing a statutory trust in respect of such client money and limiting the circumstances in which client money may be withdrawn from client money accounts.

Once money has been withdrawn from client accounts it exposes clients to higher levels of counterparty risk. Namely, a higher risk that clients may not be able to recover their money if there is a deficit in the client money account operated by the clients' participant and the participant becomes insolvent and is unable to pay the deficiency or if monies outside the client money account are sought to be treated by the participant's external administrator as an asset of the participant available for distribution to creditors (instead of or ahead of clients). Even where client monies are ultimately returned to the client in the case of an insolvency of a participant, it also may take longer to determine the client's entitlement to money outside the client trust account and to retrieve that money.

Accordingly, breaches of the client money provisions risk undermining investor confidence in the provision of financial products and services by participants.

(d) Section 4.23 of the ASX CR is designed to (amongst other things):

i. reinforce the client money obligations contained in the Corporations Act for money received by clearing participants in relation to Market Transactions to which Division 2 of Part 7.8 of the Corporations Act applies, requiring that it be held in trust by the participant; and

ii. enable a participant to identify, amongst other things, any breaches of the client money provisions under the Corporations Act and ASX CR.

(e) ASX CR 4.24 was introduced as part of operating rule and system changes ASX made in April 2014 and May 2015 to enhance protections for buying and selling clients during the settlement cycle, namely if a client's participant becomes insolvent between the execution and settlement of that client's transaction. These built on existing client asset protections in the Corporations Act, ASIC Market Integrity Rules and the ASX CR.

The enhanced protections for buyers under ASX CR 4.24 seek to ensure that if the client's participant becomes insolvent during the course of the purchase transaction and the client does not get access to the securities purchased, that at least the funds paid by the client in respect of the purchase remain in trust for the benefit of the client.

These enhanced client protections are relied on by ASX to achieve compliance with its obligations under FSS 13 for central counterparties dealing with segregation and portability. This is on the basis that, in the context of the single account structure utilised by ASX for each participant's house and client positions that applies for post trade processing of cash market transactions, its arrangements (including under the enhanced client protections under ASX CR 4.24) provide clients with protections for their assets that are considered materially equivalent to those afforded by segregated house and client accounts[1].

(f) The contraventions by Morrison were not immaterial, with the total amount of funds of other clients that were removed from trust, and subject to potential counterparty exposure to Morrison until those amounts were subsequently paid into trust, being in aggregate:

i. up to approximately AUD $25 million in respect of uncleared funds across the Relevant Period for Uncleared Payments; and

ii. over AUD $1 million in respect of dishonoured direct debit payments across the Relevant Period for Dishonoured Payments.

(g) There was no evidence of any losses suffered by clients;

(h) With respect to the factors in determining sanctions that relate to a participant's culpability for a contravention and mitigating and aggravating factors, as set out in Annexure A to the Enforcement and Appeals Rulebook Procedures, refer to paragraphs (i) to (r) below;

(i) The Contraventions were inadvertent and unintentional;

[1] Refer to FSS 13.1 and 13.2 of RBA's 2018/19 assessment of ASX Clear Pty Limited available here.

(j) Where ASX is satisfied that a participant's breach of an operating rule is one which ought to have been prevented or mitigated by its arrangements for complying with the operating rules, then it considers it open to reach a finding that the participant did not have adequate processes to comply with the relevant obligation. Relevantly ASX considers that:

i. its existing guidance to participants:

a. that their processes for complying with the client money requirements are key processes for the purpose of complying with their obligations under the ASX CR (refer to section 3.5 of ASX CR Guidance Note 1);

b. to review their compliance measures when there are changes to their business and to identify changes that may impact their effectiveness (refer to section 6 of ASX CR Guidance Note 1);

ii. the circumstances of Events 1 and 2, including:

c. Morrison's failure to have in place processes to ensure that uncleared funds and dishonoured payments would not be moved from its trust accounts, or to identify any such movement;

d. Morrison's apparent failure to have adequately reviewed its compliance measures for client money requirements and to identify the impact on their effectiveness from the settlement of trades through a direct debit facility operating in connection with the New Trust Account following the migration of clearing and settlement services in respect of D2MX clients to Morrison from 28 August 2018,

support such a finding.

(k) Morrison did not derive a financial benefit or other commercial advantage from the contravention;

(l) Morrison did not act unconscionably towards, or otherwise unfairly take advantage of, clients or counterparties;

(m) Morrison self-reported the circumstances which are the basis of the Contraventions in a candid manner;

(n) Morrison demonstrated an overall cooperative stance with ASX in its investigations of the breaches;

(o) Morrison made an early decision to admit the contraventions of the ASX CR;

(p) Morrison undertook remedial action once it became aware of the contraventions of the ASX CR;

(q) The extended duration of and failure to identify the movement of uncleared funds and dishonoured payments in respect of direct debit facility, being over two and a half months in the case of Event 1 and over one month in the case of Event 2;

(r) Morrison has a good history of complying with the operating rules;

(s) Having regard to the "totality principle" and that the breaches the subject of:

i. Contraventions 1, 3 and 5 arose from a single course of conduct (Event 1);

ii. Contraventions 2, 4 and 6 arose from a separate single course of conduct (Event 2); and

iii. Contravention 7 are established co-extensively with the breaches the subject of the above Contraventions,

ASX considers it appropriate to apply:

iv. an overall penalty across the Contraventions arising from Event 1 (i.e. Contraventions 1, 3 and 5 and Contravention 7 to the extent it relates to Event 1); and

v. an overall penalty across the Contraventions arising from Event 2 (i.e. Contraventions 2, 4 and 6 and Contravention 7 to the extent it relates to Event 2),

notwithstanding that an aggregation of penalties for each individual contravention may be higher.

Sanction Guidelines

The CCO determined that, given the circumstances in this matter, a total fine of $80,000 (plus GST), comprising amounts of:

(a) $50,000 (plus GST) in relation to the Contraventions relating to Event 1 (i.e. Contraventions 1, 3, 5 and 7); and

(b) $30,000 (plus GST) in relation to the Contraventions relating to event 2 (i.e. Contraventions 2, 4, 6 and 7),

was an appropriate sanction.

The CCO is of the opinion that this sanction will act as a deterrent and appropriately serves the interests of ASX and its participants.