

ASX Settlement and Austraclear Participant Default - Overview

This summary information is provided for guidance only and should be read in conjunction with the ASX Settlement Operating Rules and Austraclear Regulations. It does not replace or vary those Operating Rules.

Role of settlement facility

ASX Settlement operates a settlement system for securities traded on Australian financial markets, facilitating payment and delivery under such transactions. Settlement of these securities transactions is conducted via the Clearing House Electronic Subregister System (CHES), and occurs through a daily multilateral net batch settlement¹ on a delivery versus payment (DvP)² basis.

ASX Settlement also acts as securities depository for registering title (ownership) of securities on the CHES sub-register.

Austraclear provides depository, registration, cash transfer and settlement services for debt instrument securities in Australian financial markets. Settlement of these securities transactions occurs through real-time gross settlement³ (“RTGS”) on a DvP basis.

Austraclear also facilitates cash transfers including for the payment of margin obligations across futures, exchange traded options and cash market products and also offers a collateral management service.

Regulatory and legal context

ASX Settlement and Austraclear are licensed operators of clearing and settlement facilities under the Corporations Act 2001 (Cth). They have a number of statutory obligations including, to the extent that it is reasonably practicable to do so⁴:

- to comply with the Financial Stability Standard for Securities Settlement Facilities (FSS) published by the Reserve Bank of Australia and to do all other things necessary to reduce systemic risk; and
- to do all things necessary to ensure that their services are provided in a fair and effective way.

The arrangement for netting of payment and delivery obligations under the ASX Settlement Operating Rules and the Standard Client Payments Provider Deeds⁵ constitutes an approved ‘multilateral netting arrangement’ under the Payment Systems and Netting Act 1998 (Cth) (the Act).

¹ This occurs once a day, with a participant’s security and payment obligations / entitlements calculated on a net basis (or if they have more than one PID, on a per PID basis) across instructions due for settlement on that day.

² DvP is a settlement mechanism that involves the simultaneous movement of securities from the seller to the buyer once payment for the trade has been made through electronic transfer of funds.

³ This occurs on a per transaction basis, with a participant’s security and payments obligations / entitlements calculated separately for each transaction.

⁴ Refer to section 821A of the Corporations Act.

⁵ The Standard Client Payments Provider Deed is an agreement entered into by ASX Settlement, ASX Clear (the central counterparty for cash market products), Australian Payments Network Limited and each bank that provides payment facilities to ASX Settlement participants (referred to as payments providers).

The Act provides protection from reversal or invalidation under insolvency law for the netting of obligations and payments or transfer of property to meet net obligations as part of settlements effected through the netting arrangement⁶. The settlement facility retains discretion as to whether it allows outstanding cash market transactions of an externally administered settlement participant to proceed to settlement.

The Austraclear system constitutes an approved RTGS system under the Act. The Act provides protection from reversal or invalidation under insolvency law for payments and transfers of assets through the RTGS system⁷.

The conduct of the settlement facilities and their respective settlement participants is governed by the operating rules of the relevant settlement facility, which operate as a contract between the settlement facility and its participants. Among other things, these rules set out the circumstances in which the settlement facility may declare an “event of default” in respect of a settlement participant, and the steps that it may take as a consequence.

Default events

The operating rules of the settlement facility set out a number of events or circumstances which they may treat as an “event of default” by a settlement participant. These include:

- the participant no longer meets the eligibility requirements for participation;
- the participant becomes an externally administered body corporate⁸ (e.g. it has a liquidator, administrator or receiver appointed); or
- the participant’s payments provider⁹ or the participant bank¹⁰ at which the participant maintains its nominated account becomes an externally administered body corporate or does not authorise a payment obligation.

The range of circumstances which the settlement facilities may treat as an event of default is not restricted to financial failures. The settlement facilities may, for example, declare an event of default where the settlement facility is no longer satisfied that the settlement participant has the operational capacity to meet its obligations to the settlement facility (e.g. to communicate reliably with CHES or the Austraclear system).

⁶ The RBA has also declared that the Austraclear System is an approved multilateral netting arrangement under the Act, although Austraclear does not routinely offer deferred net settlement functionality.

⁷ The RBA has also declared CHES an approved RTGS system under the Act, although ASX Settlement’s RTGS functionality is not currently used. The Reserve Bank Information and Transfer System (RITS) in relation to which Austraclear and ASX Settlement are ‘feeder systems’ is also an approved RTGS system.

⁸ Referred to as a “Chapter 5 body corporate” in the Corporations Act 2001 (Cth).

⁹ Banks that facilitate the settlement of money in RITS on behalf of ASX Settlement participants for which it provides payment facilities.

¹⁰ A bank or other entity that provides banking services to other Austraclear participants including the settlement of money through RITS.

Default powers

If a settlement facility declares an event of default in relation to a settlement participant, the settlement facility has the power to take a variety of steps, including but not limited to:

- imposing restrictions on the participation of that participant;
- suspending or terminating the participation of the defaulting participant; or
- giving the participant's clients access to holdings controlled by the participant or the withdrawal from that facility of securities that had been deposited by the participant.

Participation in settlement following default

Upon a default, ASX Settlement would ordinarily suspend the participation of the defaulting participant, resulting in the suspension of all batch instructions of the defaulting participant that are outstanding at the time of suspension¹¹.

ASX Settlement may however facilitate the ongoing participation of a defaulting participant, and allow its outstanding cash market transactions to proceed to settlement on condition that the participant (or its external administrator):

- confirms that it has the required funds and/or financial products (as applicable) to meet the participant's net settlement obligations for existing cash market transactions on the relevant settlement date;
- has ongoing capacity to perform the participant's functions in the batch settlement process and meet obligations under that process, e.g.:
 - adequate staff and infrastructure to receive, issue and process messages in the CHES system and to meet obligations for payment into trust or restrictions on withdrawals from trust of moneys in connection with the settlement of client transactions¹²;
 - continuing payment provider arrangements to facilitate payment or receipt of funds; and
- meets any other preconditions for settlement.

Similarly, Austraclear would ordinarily suspend the participation of a defaulting participant but may instead permit it to continue to use the facility subject to conditions on the participant (or its external administrator) that it considers appropriate, including:

- restricting its activities in the facility in a specified manner;
- requiring the participant to provide to Austraclear information or reports on specified matters and at specified times; and
- provision of a solvency statement on a specified basis to Austraclear.

If an Austraclear participant is suspended, no transaction to which the participant is a party will settle through

¹¹ As indicated in the Clearing Participant Default Overview, upon a clearing participant default, the central counterparty would also ordinarily close out on market the defaulting clearing participant's net unsettled position in each cleared financial product class.

¹² ASX Settlement Rules 6.3B and 10.10A impose obligations to pay into trust amounts due to clients in connection with the settlement of sales of their financial products. ASX Clear Operating Rule 4.24 also imposes restrictions on withdrawals from trust in connection with the purchase of financial products.

the Austraclear system.

Securities in settlement facility

A settlement participant of ASX Settlement can maintain securities holdings on the CHESSE Subregister (“CHESSE Holdings”) for clients of which it is the sponsoring participant or which it otherwise controls on its own behalf or on behalf of a related body corporate. Sponsored CHESSE Holdings remain in the name of the client.

A settlement participant of Austraclear can deposit eligible securities in the Austraclear System. Those securities will be in the name of the participant or Austraclear (as nominee for the participant).

Dealing with securities in settlement facility on suspension of settlement participant

If a settlement participant of ASX Settlement is suspended from participation, the operating rules of the settlement facility allow for CHESSE Holdings controlled by the participant to be transferred to another sponsoring participant or converted to issuer sponsored by ASX Settlement¹³ where:

- notice has been given to ASX Settlement by the relevant holder requesting that transfer or conversion and ASX Settlement notifies the defaulting participant of its intention to do so; or
- ASX Settlement notifies the holder or publishes on 2 occasions its intention to do so.

ASX Settlement may however facilitate the ongoing participation of an externally administered settlement participant so that the defaulting participant can undertake an orderly wind down of CHESSE Holdings it controls (e.g. by allowing the participant to give effect to client instructions to transfer to a new sponsoring participant or convert to issuer sponsored their CHESSE holdings or to move securities from its settlement and accumulation accounts¹⁴ to sponsored holdings or issuer sponsored holdings of the client to which those securities relate), where the participant (or its external administrator):

- confirms it will expeditiously process client instructions to transfer or convert sponsored holdings of the participant;
- has the ongoing capacity to perform the participant’s functions in the orderly wind down of CHESSE Holdings it controls and meet obligations under that process, e.g.:
 - adequate staff to receive and expeditiously give effect to client instructions;
 - adequate staff and infrastructure to receive, issue and process messages in the CHESSE system; and
- meets any other preconditions for dealing with holdings in the CHESSE system.

Where a settlement participant of Austraclear is suspended from participation, it will be required to make alternate arrangements for holding deposited securities, for example, by holding through another Austraclear participant or, where permitted, withdrawing its securities from the facility and holding directly on the issuer’s register.

¹³ Where the holder’s controlling participant asserts contractual or other rights in relation to the CHESSE holdings, for example to secure any outstanding amounts the holder owes to the controlling participant, the transfer or conversion may be subject to resolution of such aspects.

¹⁴ A settlement participant is required to establish an accumulation account and settlement account in the name of a nominee company to hold securities for the purpose of facilitating settlement of transactions in those securities.