

## **ASX Compliance Enforcement Activity**

Under the Corporations Act, as a licensed operator of financial markets, ASX is obliged to have adequate arrangements for monitoring and enforcing compliance with the operating rules of those markets. It is also obliged, as a licensed operator of clearing and settlement facilities, to have adequate arrangements for supervising those facilities and for enforcing compliance with their operating rules.

The purpose of this circular is to notify participants in those markets and facilities of some of the enforcement activities recently undertaken by ASX Compliance, so that they are aware of potential areas of concern for ASX and of ASX's enforcement activities in those areas.

This circular covers enforcement activities that were finalised during the period ending 30 March 2021. Investigations in relation to other enforcement matters are ongoing.

### **Foreign orders on Option Market Contracts**

ASX issued a warning letter to a participant in relation to apparent breaches of ASX Operating Rules ('**ASX OR**') and Procedures concerning accepting orders from United States ('**US**') Eligible Broker-Dealers ('**EBDs**') and Eligible Institutions ('**EIs**') in relation to Option Market Contracts.

In order to accept Orders from US EBDs and EIs in Option Market Contracts, a participant is required to first satisfy each of the criteria in ASX OR 2241. One of these includes obtaining written representations in the form set out in ASX OR Appendix 2241(b). The participant failed to comply with this requirement from three US EBDs / EIs between 1 July 2019 and 26 May 2020.

The participant undertook the following steps to remediate the issue, which were considered by ASX to be reasonable to prevent future breaches:

- It issued written representations in the correct format to the three US EBDs / EIs.
- It implemented pre-trade procedures to notify it when US-domiciled clients wish to trade Option Market Contracts before transactions are accepted.
- It implemented a post-trade review that will review new US-domiciled clients that have traded in Options Market Contracts to ensure that the requisite pro-forma written representations have been signed.

### **Client money requirements**

ASX issued a warning letter to a participant in relation to apparent breaches of the client money requirements in the ASX Clear Operating Rules ('**ASX CR**').

The participant in question transferred in error an amount in excess of \$30 million from its trust account to its general account for a transaction on behalf of a client, representing a breach of the obligation in ASX CR 4.23.2 to ensure that client money is held in trust at all times. The error was the result of a manual process which allowed the incorrect tag to be applied to the client's account, assigning it as Free of Payment rather than Delivery versus Payment. The error was also not captured by the usual 'maker/checker' process prior to the transfer, but identified later that day where the participant was able to unwind it. The participant also failed to notify ASX of the deficiency of funds in its trust account until after the passage of two business days and therefore breached its obligations under ASX CR 4.23.7.

The participant undertook the following steps to remediate the issue, which were considered by ASX to be reasonable to prevent future breaches:

- Its procedures were updated to incorporate the template reconciliation from ASX CR Guidance Note 12 into its trust reconciliation process.



- It established an enhanced monthly governance forum for stakeholders to review key performance indicators and review validity of all processes and protocols against regulations.
- It implemented measures to enhance supervision within the settlements team to ensure segregation between employees who perform the input, conduct validation and supervise checklists on a daily basis. Supervisory approval of the daily checklist is also performed by a Vice President.
- It conducted a review of all operating procedures to ensure ASX CR trust obligations were properly reflected.

ASX also recommended that the participant:

- Automate its back-office account processes in its clearing and settlement system as an additional control to its Trust Account processes.
- Investigate whether additional reports can be generated to verify transactions pertaining to trust.

### **Business continuity and disaster recovery**

ASX issued a warning letter to two participants in relation to compliance with business continuity and disaster recovery requirements under the operating rules. The matters came to light as part of ASX Compliance's gap analysis review in relation to these obligations.

The first case concerned compliance with ASX Settlement Operating Rule ('**ASX SR**') 6.21.1, requiring the maintenance of disaster recovery and business continuity arrangements that are adequate to ensure the timely recovery of its usual operations, and allowing ASX to require a participant to undertake testing of these arrangements at such times and in such a manner as may be specified by ASX.

ASX SR Guidance Note 10 ('**GN 10**') sets out ASX's interpretation of the obligation in ASX SR 6.21.1. GN 10 provides that ASX expects each participant to undertake annual testing of its arrangements. This is so that a participant can reasonably ensure compliance with the obligation to "maintain" arrangements that are "adequate". In this case, the participant failed to keep records to verify that it had conducted testing that conformed to the expectations in GN 10. ASX therefore considers this to be an apparent breach of ASX SR 6.21.1.

In response to identification of the breach, the participant commenced an annual testing program in May 2020 and reported achieving recovery time objective results within the participant's tier group as specified in GN 10, which ASX considered was adequate to address the issue.

The second case concerned another participant's compliance with the same ASX SR and the corresponding obligation in the ASX CR. The participant acknowledged that it had not completed fail-over testing of its key clearing system since the requirement was introduced in 2011, constituting an apparent breach of ASX CR 4.2.1 (and its procedure) and ASX SR 6.21. However, the participant then also failed to conduct that testing by the date to which it committed following identification of the initial breach.

Following identification of the breach, the participant completed the required testing, which ASX considered to be adequate to address the issue.

### **Conditions on the admission of foreign participants**

ASX has issued a warning letter to a foreign-domiciled principal trader on the ASX 24 market following its change from a limited liability company to a partnership, contrary to an admission condition imposed under ASX 24 Operating Rule ('**ASX 24 OR**') 1000(a) that it be duly incorporated as a company. The breach was discovered by ASX sometime after the change had been effected. Accordingly, this amounted to an apparent breach by the participant of its obligations to continue to satisfy its admission requirements (ASX 24 OR 1400(a)), to comply with any conditions imposed on it (ASX 24 OR 1400(b)), and to notify ASX of a change in the name under which it carries business and to include full details of the change (ASX 24 OR 1400(e)).

