



ASTC Settlement Rules

Guidance Note No 12

KEY TOPICS

1. Methods of access to CHESS Holdings by Issuers
2. Controlling Participants to authorise Holding Adjustments by Issuers

ASTC Settlement Rules

1.5.14

Cross-reference

1.None

Guidance Note History

Issued:

03 February 2006

ACCESS TO CHESS HOLDINGS BY ISSUERS

Purpose

The purpose of this Guidance Note is to provide guidance to Market Participants in relation to the application of ASTC Settlement Rule 5.14 ("Rule 5.14").

Unless otherwise specified, capitalised terms in this Guidance Note have the meaning given to them in the ASTC Settlement Rules ("Rules").

Background

Rule 5.14 restricts access to CHESS Holdings by Issuers. It states that:

An Issuer must not:

- (a) *Transmit a Message that initiates a Holding Adjustment or a Financial Products Transformation in relation to a CHESS Holding; or*
- (b) *take any other action that has the effect of deducting Financial Products from or transferring Financial Products to a CHESS Holding,*

unless it is entitled to Transmit that Message or take that action.

Previously, there have been a number of waivers of Rule 5.14 requested by Issuers and granted by ASTC. Waivers have most commonly been requested and granted in relation to security sale facilities, buy-backs and redemptions of securities. The effect of the waivers has been to allow Issuers to initiate movements of securities on CHESS without the involvement of the Controlling Participant. Waivers have been granted by ASTC on the basis that there is a monetary limit to the size of the Holding that may be affected by the facility, and that limit is acceptable to ASTC.

ASTC's concern, when considering requests for waivers of Rule 5.14, has been in relation to Holdings the subject of a broker's or margin lender's lien or other security interest. Rule 5.14 protects the legitimate interests of the holders of such security interests by



limiting the ability of Issuers to take any action that has the effect of moving securities on CHESS without the involvement of the Controlling Participant. When granting waivers of Rule 5.14, ASTC has required that Issuers notify all Controlling Participants of the relevant Holders so that they are given the opportunity to protect any lien or other security interest in respect of the relevant Holdings. While this approach has worked effectively, it places the onus on the holder of a security interest to take positive action to protect that interest in a manner that may not have been contemplated, given the normal operation of Rule 5.14.

As margin lending is an established feature of the market, and one that is considered likely to continue to grow, ASTC considers that it is necessary to develop an approach to Rule 5.14 that appropriately balances the legitimate interests of the holders of brokers' or margin lenders' liens or other security interests, against the requirements of Issuers.

Methods of access to CHESS Holdings by Issuers

From the perspective of Rule 5.14, there are generally two methods by which a security sale facility, buy-back, redemption or similar facility has been conducted.

The first method is for the Issuer and the Holder to deal directly with each other, and for the Issuer (or its registry) to initiate the necessary Holding Adjustment or other action in relation to the Holder's securities. This method requires a waiver of Rule 5.14 as described above. ASTC has generally attached conditions to these waivers, including requiring the Issuer to notify all Controlling Participants of Holders who have elected to participate in the facility, giving the Controlling Participant the opportunity to object to the Holding Adjustment to protect any lien or other security interest in respect of that Holding.

The second method is for the Holder to deal with the Issuer through the Controlling Participant. For instance, the Issuer notifies the Holder of the facility, the Holder notifies the Controlling Participant that they wish to participate in the facility (for example, by forwarding the election notice to the Controlling Participant), and the Controlling Participant then directs this instruction to the Issuer (or its registry) and/or deals directly with the Holder to protect any lien or other security interest of the Controlling Participant in respect of that Holding. No waiver of Rule 5.14 is required for this method.

From the perspective of an Issuer or a Controlling Participant which does not have any security interests at risk, the first method has practical advantages. However, it involves an increase in risk for Controlling Participants with security interests at stake. The second method involves an additional step, and is accordingly less efficient in purely practical terms, but more effectively protects the interests of Controlling Participants with security interests at stake. It is also consistent with the basis of the CHESS system, under which the Sponsoring Participant has control over CHESS Holdings.

Controlling Participants to authorise Holding Adjustments by Issuers

In view of the growth of margin lending services in the market, ASTC considers that it is appropriate for Issuers to use the second method referred to above. Accordingly, waivers of Rule 5.14 will not generally be granted to facilitate Holding Adjustments by Issuers as has previously been the case. While this may involve some additional practical difficulties for Issuers and some Controlling Participants, it is intended this will be a



short-term inconvenience. ASTC proposes to address this by making enhancements to the CHESS system, which are expected to be in effect by the second half of 2006. It is proposed that these enhancements to the CHESS system will enable a Controlling Participant to direct a Holder's instruction to the Issuer by Transmitting a Message in CHESS.

Accordingly, where a Holder wishes to participate in a security sale facility, buy-back, redemption or similar facility, it will be necessary for the Holder to notify the Controlling Participant that they wish to participate in the facility (generally, by providing a completed application form or equivalent document), and the Controlling Participant then endorses and directs this instruction to the Issuer (or its registry) and/or deals directly with the Holder to protect any lien or other security interest of the Controlling Participant in respect of that Holding.

Qualification

ASTC has published this note to promote commercial certainty, and assist Market Participants. Nothing in this note necessarily binds ASTC in the application of the Rules in a particular case. In issuing this note ASTC is not providing legal advice and Market Participants should obtain their own advice from a qualified professional person in respect of their obligations. ASTC may replace this Guidance Note at any time. Readers may contact ASTC to ensure they have the latest version.