

# Monitoring and Enforcing Compliance with ASX's Operating Rules



## 1. Introduction

As the licensed operator of markets<sup>1</sup> and clearing and settlement facilities<sup>2</sup> in Australia, the ASX Limited group (“ASX”) is obliged under the *Corporations Act 2001 (Cth)*<sup>3</sup> to have rules (“operating rules”<sup>4</sup>) governing the operation of, and the conduct of the parties (“participants”<sup>5</sup>) who transact business in, those markets and facilities.<sup>6</sup> It is also obliged to have “adequate arrangements”:

- for “monitoring and enforcing compliance” with the operating rules of its licensed markets;<sup>7</sup> and
- for “enforcing compliance” with the operating rules of its licensed clearing and settlement facilities.<sup>8</sup>

This document summarises some of the arrangements that ASX has in place for monitoring and enforcing compliance by participants with its operating rules.

## 2. The obligation of participants to comply with the operating rules

Upon being admitted to transact business in an ASX market or clearing and settlement facility, a participant becomes legally bound to comply with the operating rules of that market or facility.<sup>9</sup>

Broadly speaking, the obligations imposed on participants in an ASX market or clearing and settlement facility under its operating rules fall into three main categories:

- the requirements they must meet in order to be admitted as, and to remain, a participant of the market or facility;
- the requirements they must meet when they transact business in the market or facility; and
- other requirements, including the requirement for a participant to self-report to ASX any significant breach of the operating rules.<sup>10</sup>

## 3. The role of ASX Participants Compliance

ASX Participants Compliance (“Participants Compliance”) is a specialist unit within ASX with overall responsibility for monitoring and enforcing compliance by participants with the operating rules. It reports to the ASX Chief Risk Officer (“CRO”).<sup>11</sup>

Participants Compliance has the delegated authority from the ASX Board to make compliance and enforcement decisions under the operating rules, including:

- confirming that an entity applying for admission as a participant in an ASX market or clearing and settlement facility meets the requirements in the operating rules to be admitted as a participant;
- investigating a suspected breach by a participant of the operating rules;
- taking action against a participant for breaching the operating rules; and
- granting waivers of the operating rules.

### Admission applications

Participants Compliance reviews all applications for admission as a participant in an ASX market or clearing and settlement facility. Excluding Austraclear participants,<sup>12</sup> ASX’s admission procedures for participants require Participants Compliance to confirm to the relevant ASX group executives who approve the admission of a participant that the applicant meets the admission requirements in the operating rules<sup>13</sup> before ASX will admit the applicant as a participant.<sup>14</sup>

### **ASX compliance advisers**

Excluding Austraclear participants,<sup>15</sup> when a participant is admitted to an ASX market or clearing and settlement facility, Participants Compliance will assign one of its compliance advisers to be the participant's primary ASX contact for operating rule matters. The role of the compliance adviser is to assist the participant on any questions or concerns it may have, and to liaise with the participant on any questions or concerns Participants Compliance may have, under the operating rules.

### **Participant engagement program**

Excluding Austraclear participants,<sup>16</sup> Participants Compliance engages regularly with participants so that it has up-to-date information about their business model and compliance framework. Participants Compliance also monitors various key indicators to determine if there may have been a change to the participant's business model that warrants further engagement with the participant.

### **Complaints, tip-offs and referrals**

Complaints and tip-offs are an important source of intelligence on potential breaches of the operating rules. Participants Compliance receives and assesses:

- all complaints or tip-offs made to ASX alleging that a participant has breached its obligations under the operating rules;
- all compliance-related notifications by participants under the operating rules, including self-reports of significant breaches of the operating rules;<sup>17</sup> and
- referrals from other ASX control groups regarding suspected breaches of the operating rules they may have detected in the course of their activities (see section 5 below),

to determine whether they warrant further action by Participants Compliance.

### **Compliance reviews**

From time to time, Participants Compliance conducts risk-based thematic compliance reviews to test the level of understanding of, and compliance with, particular obligations under the operating rules. A particular rule obligation may be selected for a thematic review for a variety of reasons, including:

- ASX regards the rule as a key investor protection or as having a relatively high level of operational or compliance risk attached to it;<sup>18</sup>
- ASX has detected multiple instances of non-compliance with the rule; or
- ASX has previously conducted a thematic review of the rule and wants to test whether that review has been successful in raising the level of compliance.

Sometimes these thematic reviews are conducted across all participants affected by a particular rule obligation and sometimes they are conducted on a "sample and test" basis across selected participants.

Participants Compliance similarly conducts from time to time participant-specific compliance reviews to test the quality of a particular participant's compliance processes, either generally or in relation to particular rule obligations. A participant may be selected for such a review because, for example:

- the discussions ASX has had with the participant as part of its engagement program have given rise to a concern that the participant's compliance framework has not kept pace with changes in its business model, or
- ASX is concerned by the number, frequency or severity of the operating rule breaches committed by the participant that ASX has detected in its monitoring activities.

Participants Compliance additionally conducts a number of periodic data-based reviews to test the level of compliance with specific reporting requirements or deadlines for action under the operating rules.

### **Investigations**

If as a result of its monitoring activities Participants Compliance suspects that a participant has committed a breach of the operating rules, it may conduct a formal investigation to determine if that suspicion is well-founded.

Under the operating rules, Participants Compliance can require a participant to provide information and access to books and records that may be relevant to assessing the participant's compliance with the operating rules. Participants Compliance may also require any such information to be verified by an independent auditor or other expert.

If a participant does not co-operate with Participants Compliance in providing the required information or books and records, that will constitute a separate actionable breach of the operating rules.

### **Ameliorative or remedial action**

If Participants Compliance considers it appropriate, it may exercise ASX's power to impose conditions on the admission<sup>19</sup> of a participant to an ASX market or facility to ameliorate or remediate a breach or suspected breach of the operating rules.<sup>20</sup> Examples of the types of conditions Participants Compliance has imposed in this regard include:

- in the case of a clearing participant, requiring the participant to pay additional margin or to hold additional capital to help cover the additional risk for the clearing house arising from the breach or from the gaps in the participant's compliance framework revealed by the breach;
- limiting a participant's right to deal in particular products or to provide particular services; and
- requiring the participant to engage an independent expert to review and recommend changes to its operations or compliance framework.

If the breach involves an event of default under the relevant operating rules, Participants Compliance may also exercise ASX's power under those rules to restrict, suspend or terminate the participant's right to deal in particular products or its admission or access to a particular market or clearing and settlement facility.<sup>21</sup>

Not all breaches of the operating rules by a participant will warrant ameliorative or remedial action by Participants Compliance. For less serious breaches, Participants Compliance may simply:

- send a formal warning letter to the participant acknowledging the breach and noting that ASX is likely to take enforcement action if the breach is repeated or if the participant does not implement steps to avoid the breach being repeated;
- send a "no escalation" letter to the participant acknowledging the breach but indicating that ASX does not intend to take the matter further;<sup>22</sup> or
- simply note the breach in ASX's participant breach register so that it can take it into account, if appropriate, in future action against the participant.

### **Waiver decisions**

Participants Compliance reviews and decides all applications for a waiver of an operating rule by a participant, or an entity applying to be admitted as a participant, in an ASX market or clearing and settlement facility.

Participants Compliance will generally only grant a waiver of an operating rule if it is satisfied that the waiver conforms to ASX policy and the applicant has a good business reason for requesting it.<sup>23</sup>

## 4. Enforcement proceedings

If Participants Compliance determines that a participant has breached the operating rules, it may refer the breach to ASX's Enforcement Unit ("**ASX Enforcement**") for it to consider initiating formal enforcement proceedings against the participant under the ASX Enforcement and Appeals Rulebook.<sup>24</sup> ASX Enforcement is a separate division in the executive office of the ASX Chief Compliance Officer ("**CCO**"). It operates independently of Participants Compliance.

Under the ASX Enforcement and Appeals Rulebook ASX may impose:

- a monetary penalty of up to \$250,000 for a breach of the ASX or ASX 24 operating rules and up to \$1,000,000 for a breach of the ASX Clear, ASX Clear (Futures) or ASX Settlement operating rules or the Austraclear Regulations; and
- a range of other sanctions, including a censure, an order for the participant to institute an education and compliance program, or the imposition of conditions or restrictions on the participant's admission or access to the relevant market or clearing and settlement facility.

The decision to impose a sanction under the ASX Enforcement and Appeals Rulebook is made on behalf of ASX by the CCO. If a participant is dissatisfied with the CCO's decision, it may appeal the decision to the ASX Appeal Tribunal.<sup>25</sup>

## 5. The role of other ASX control groups

Participants Compliance is not the only ASX control group responsible for monitoring and enforcing compliance by participants with the operating rules. Other ASX control groups, mentioned below in this section, also play an important role in monitoring and enforcing compliance with the operating rules relevant to their respective areas of responsibility.

If they suspect a participant has breached the operating rules, they will refer the matter to Participants Compliance so that it can determine whether it ought to take further action in relation to the suspected breach.

### Counterparty Risk Assessment ("**CRA**")

CRA monitors compliance by participants in ASX's two clearing houses<sup>26</sup> with their capital requirements under the operating rules. Participants in those clearing houses are generally required to lodge monthly capital returns with CRA.<sup>27</sup> CRA can also require them to lodge ad hoc capital returns at any time.

CRA's compliance-related responsibilities include monitoring for late lodgement of capital returns; monitoring for potential breaches of ASX's capital requirements; and conducting trend analysis to identify participants that may face difficulty in the future in complying with ASX's capital requirements and placing them "on watch".

### Clearing Risk Management ("**CRM**")

CRM is responsible for managing the level of risk in ASX's clearing houses. CRM's compliance-related responsibilities include setting and monitoring capital based position limits, stress test exposure limits and position concentration limits; and managing the default process, clearing fund contributions and recovery assessments in the event that a clearing participant defaults in their obligations to the clearing house.

### Participants Review

The Participants Review team is responsible for reviewing participants' business continuity and disaster recovery plans for conformity with ASX's guidance on such plans.<sup>28</sup> From time to time, it also conducts individual and industry-wide risk reviews to test the level of non-financial risk being carried by participants.

## Market Operations

Market Operations is responsible for the day to day operation of ASX's markets. Its compliance-related responsibilities include assessing trade reporting requests and trade cancellation requests for compliance with the operating rules and responding to instances where a market may have become disorderly.<sup>29</sup>

## Clearing and Settlement Operations

Clearing and Settlement Operations is responsible for the day to day operation of ASX's clearing and settlement facilities. Its compliance-related responsibilities include monitoring compliance by participants with their primary clearing and settlement obligations<sup>30</sup> and responding to instances where the proper functioning of a clearing and settlement facility may be in jeopardy.

## 6. Notifications to ASIC

If ASX suspects that a participant has committed a significant contravention of the operating rules or the Corporations Act, it is required under that Act<sup>31</sup> to give a notice to the Australian Securities and Investments Commission ("ASIC") with details of the contravention. The purpose of the notice is so that ASIC can then consider whether it wishes to take criminal or other regulatory action in relation to the suspected breach.

ASX is also required to notify ASIC of any disciplinary action it takes against a participant for breaching the operating rules.<sup>32</sup>

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<sup>1</sup> The ASX and ASX 24 markets.

<sup>2</sup> The ASX Clear, ASX Clear (Futures), ASX Settlement and Austraclear clearing and settlement facilities. ASX Settlement is the operator of the Clearing House Electronic Subregister System (or CHES).

<sup>3</sup> Referred to in this document as the "**Corporations Act**". References in this document to sections are to sections of the Corporations Act.

<sup>4</sup> ASX's operating rules include the ASX Operating Rules, ASX 24 Operating Rules, ASX Clear Operating Rules, ASX Clear (Futures) Operating Rules, ASX Settlement Operating Rules and Austraclear Regulations. They are supplemented by the ASX Enforcement and Appeals Rulebook and the ASX Recovery Rules.

References in this document to the operating rules of the ASX market exclude the rules governing the quotation of warrants and AQUA products in Schedules 10 and 10A of the ASX Operating Rules respectively. Compliance with those rules is monitored and enforced by ASX Investment Products Compliance rather than ASX Participants Compliance.

Otherwise, references in this document to rules are to the operating rules of the relevant ASX market or clearing and settlement facility.

<sup>5</sup> The expression "participant" includes brokers who trade on the ASX or ASX 24 market, clearers who clear in the ASX Clear or ASX Clear (Futures) clearing facilities, and settlement agents who settle transactions through the ASX Settlement (CHES) and Austraclear settlement systems.

<sup>6</sup> The operating rules must deal with the matters prescribed by the Corporations Regulations (sections 793A(1) and 822A(1)).

<sup>7</sup> Section 792A(c)(ii).

<sup>8</sup> Section 821A(c)(ii).

<sup>9</sup> In the participant application form that an applicant seeking admission as a participant in an ASX market or clearing and settlement facility submits to ASX, the applicant agrees that, if it is admitted as a participant, it will be bound by and comply with the operating rules of that market or facility. The operating rules themselves have a similar provision. These agreements are effectively given the force of law under section 793B and 822B. In addition, if a participant does not comply with the applicable operating rules, the Court may make an order compelling it to do so (section 793C and 822C).

<sup>10</sup> See ASX rule 5000, ASX Clear rule 19.2.3, ASX Settlement rule 12.18.1, ASX 24 rule 5000 and ASX Clear (Futures) rule 4.11B. Austraclear participants currently are not required to self-report significant breaches of the Austraclear Regulations to ASX.

<sup>11</sup> The CRO reports jointly to the ASX Audit and Risk Committee and to the ASX Managing Director and CEO.

<sup>12</sup> The decision to admit Austraclear participants has been delegated to Participants Compliance.

<sup>13</sup> Subject to any applicable waivers that Participants Compliance may be prepared to grant.

<sup>14</sup> Other ASX control groups must also be satisfied that the participant meets ASX's technological, operational and risk requirements and confirm that to the relevant ASX Group executives who approve the admission of a participant, before ASX will admit the applicant as a participant.

<sup>15</sup> ASX does not appoint individual compliance advisers to Austraclear participants. The participants in that facility are mostly institutional or sophisticated investors. Their operatives who access the Austraclear system are required to undertake training in the use of that system. The obligations of participants in that facility are essentially bilateral in nature. Hence Austraclear participants do not generally need the services of an ASX compliance adviser.

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- <sup>16</sup> For the same reasons as set out in note 15 above, ASX does not maintain profiles for Austraclear participants or conduct periodic engagement meetings with Austraclear participants.
- <sup>17</sup> See note 7 above.
- <sup>18</sup> For example, ASX has done a number of thematic reviews over the years into compliance by clearing participants with the trust account and client segregated account obligations in the ASX Clear rules, which ASX considers to be a key investor protections.
- <sup>19</sup> That is, a condition that a participant must comply with in order to maintain their admission as a participant in the relevant market or facility.
- <sup>20</sup> See ASX rule 1210, ASX Clear rule 3.1.4, ASX Settlement rule 4.2.4, ASX 24 rule 1210, ASX Clear (Futures) rule 4.5 and Austraclear rule 2.7.
- <sup>21</sup> See ASX rule 5160, ASX Clear rule 15.2.1, ASX Settlement rule 12.19.1, ASX 24 rule 5160, ASX Clear (Futures) rule 72.1 and Austraclear rule 3.10.
- <sup>22</sup> This may be given on a conditional basis (ie that ASX will not take further action provided the participant meets certain conditions specified in the letter).
- <sup>23</sup> Refer to Guidance Note 4 *Waivers and In-Principle Advice* in the rule book for the relevant ASX market or clearing and settlement facility for a more complete description of the factors that ASX takes into account when considering an application for a waiver of an operating rule.
- <sup>24</sup> For more information about the enforcement process, see Guidance Note 1 *Enforcement Action Against Participants* in the ASX Enforcement and Appeals Rulebook.
- <sup>25</sup> A participant may also be entitled to appeal decisions by Participants Compliance to impose conditions on its participation or to restrict, suspend or terminate its participation: see rule 3.1 of the ASX Enforcement and Appeals Rulebook.
- <sup>26</sup> ASX Clear and ASX Clear (Futures).
- <sup>27</sup> ASX Clear and ASX Clear (Futures) participants that are ADIs are not required to lodge capital returns with CRA.
- <sup>28</sup> See Guidance Note 10 *Business Continuity and Disaster Recovery* in the ASX Clear, ASX Clear (Futures), ASX Settlement and Austraclear rules.
- <sup>29</sup> Market Operations has a Market Surveillance Unit that monitors trading on the ASX and ASX 24 markets on a real time basis to detect (among other things) potential instances of disorderly trading.
- <sup>30</sup> That is, payment of initial and variation margins and satisfaction of their payment and delivery obligations at settlement.
- <sup>31</sup> Sections 792B(2)(c) and 821B(2)(c).
- <sup>32</sup> Sections 792B(2)(b) and 821B(2)(b).