



Transfers to the CHES Subregister

Response to consultation

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1. Consultation process

In July 2018, ASX released a [Consultation Paper](#) seeking feedback from stakeholders on a proposal to amend the ASX Settlement Operating Rules to streamline transfers to the CHESS subregister. The proposal was to remove the requirement for settlement participants that are not ASX trading participants (**settlement-only participants**) to receive and provide to the issuer, a registrable transfer document signed by or on behalf of the holder (**registrable transfer document**) in order to effect a transfer of an issuer sponsored holding to a CHESS holding. As a consequence, it was proposed that issuers (or their share registries) would no longer be required to receive a registrable transfer document from a settlement participant and check that the holder details on that document match the issuer's own records before authorising a transfer to the CHESS subregister. This is referred to as the **proposal** in this document.

ASX also sought feedback from stakeholders as to whether the introduction of the following additional requirements on settlement-only participants and issuers effecting transfers to the CHESS subregister (**verification steps**) would change their response to the proposal:

- settlement-only participants must provide the issuer with written details of the holder's name for the relevant SRN; and
- issuers must check that those details match the issuer's records for that holder (i.e. as recorded on the issuer sponsored subregister for that SRN) prior to authorising a transfer.

2. Consultation feedback

ASX received 12 responses to the Consultation Paper from settlement participants, industry groups, share registries and other relevant stakeholders. Of the 12 responses received:

- seven respondents supported the proposal;
- two respondents supported the proposal, provided that the verification steps described above were implemented; and
- three respondents raised additional points for consideration in relation to the proposal.

2.1. Practical enforcement of Corporations Act warranties and indemnities

One respondent raised that it may be practically difficult for a holder to enforce the warranties and indemnities provided under the Corporations Regulations, as holders are unlikely to know about these causes of action or have the means to enforce them. Another share registry respondent noted that the ability for issuers and holders to claim against a settlement participant for an unauthorised transfer is only as useful as the financial resources of a settlement participant to meet a claim.

2.2. Removal of the requirement for the issuer to check the holder's details

One respondent (a participant) considered that removing the requirement for the issuer (or their share registry) to check that the name on the registrable transfer document matched the issuer's records for that holder would reduce holder protections. This respondent argued that although the holder has legal recourse against the settlement-only participant, this is not the same as the check actually being performed as it takes time to pursue redress, is an inconvenience, and the outcome is not guaranteed.

Similarly, another industry group respondent considered that removal of the requirement for the issuer (or their share registry) to check the holder's name against their records had the potential to facilitate fraud. This respondent also noted that the availability of legal redress for holders after a transfer has occurred, is not as effective as the holder's name being verified prior to the transfer occurring.

In contrast, two respondents (one an industry group and one a participant) were of the view that the introduction of the additional verification steps would be contrary to the intent of streamlining transfers to the CHESS subregister.

2.3. Fraud/cyber risk

One industry group respondent indicated that issues of fraud and cyber risk must be adequately addressed as part of the proposed changes, on the basis that fraud prevention practices of settlement-only participants may not be adequate.

2.4. Suggested amendments to the proposal

One share registry respondent suggested that qualifying criteria should be introduced for those settlement-only participants that are not required to provide a registrable transfer document to issuers (or their share registry). It was suggested by this respondent that those settlement-only participants who receive the benefit of this exemption should have a certain regulatory status and insurance available for the benefit of issuers and holders.

The same respondent also suggested that ASX's proposal should address holder consent validation/authorisation requirements for settlement-only participants.

3. ASX response

Considering the feedback outlined above, ASX has decided to:

1. Limit the proposed removal of registrable transfer document requirements to a sub-class of settlement-only participants who meet certain qualifying criteria (referred to in this paper as "custodial settlement participants"). ASX Settlement will notify issuers that a settlement participant is a custodial settlement participant through the inclusion of the Broker Non Broker indicator on relevant CHES messages.
2. Require custodial settlement participants to undertake pre-transfer validation checks.
3. Align the treatment of custodial settlement participants with settlement participants that are ASX market participants in the manner contemplated in the Consultation Paper. That is, apply ASXSOR 9.12.4 to 9.12.8 to custodial settlement participants (instead of ASXSOR 9.12.1 to 9.12.3) and remove custodial settlement participants from the application of ASXSOR 9.8.4, so as to:
 - 3.1 remove registrable transfer document requirement for custodial settlement participants;
 - 3.2 extend existing warranties in ASXSOR 9.12.5 to custodial settlement participants; and
 - 3.3 extend the ancillary requirements for transfers specified in ASXSOR 9.12.6 to 9.12.8 to custodial settlement participants.
4. Introduce subsequent message enhancements when implementing the CHES replacement system to facilitate efficiencies for settlement-only participants who do not meet the qualifying criteria to be a "custodial settlement participant."

These changes will be implemented through the ASX Settlement Operating Rules and are subject to regulatory clearance.

In relation to share sale fraud, ASX notes the recent release of ASIC Information Statement 237.¹ The proposal outlined in this paper aims to help reduce fraud by requiring a custodial settlement participant to carry out both pre-transfer and post-transfer validation checks.

3.1. Limit the proposed removal of registrable transfer document requirements to a sub-class of settlement-only participants who meet certain qualifying criteria

In the Consultation Paper, ASX proposed removing the registrable transfer document for all settlement-only participants. In response to the issues raised by stakeholders described above, ASX will limit the implementation of the proposal to settlement-only participants that ("**custodial settlement participants**"):

¹ Accessible at: <https://asic.gov.au/regulatory-resources/markets/report-suspicious-activity/protecting-against-share-sale-fraud/>

- hold an Australian financial services licence authorising it to provide custodial or depository services (or are exempt from this requirement under Corporations Regulation 7.6.01(1)(k)); and
- either:
 - hold a minimum amount of net tangible assets in cash and liquid assets; or
 - have procured a third party guarantor who does meet the net tangible asset requirements to provide an unconditional and irrevocable guarantee in relation to any unauthorised transfers by the custodial settlement participant.

3.1.1 Hold a minimum amount of net tangible assets

ASX will rely on the net tangible asset requirements (including how much of this must be held in cash and liquid assets) imposed on providers of custodial or depository services or operators of investor directed portfolio services under sections 912AA(4)(b) and (8) or section 912AC(4)(a) and (7).² The current net tangible asset requirement under those sections is the greater of \$10 million or 10% of average revenue, and this must be held 100% in liquid assets with 50% in cash.

The purpose of the minimum net tangible asset requirement is to limit the proposal to those custodial settlement participants which meet higher financial standing requirements, in the event they need to make good holder losses caused by the custodial settlement participant's fraud or misconduct. (In doing this, ASX has sought to rely on the net tangible asset requirement set out in existing ASIC policy rather than develop a new financial requirement.)

We note that settlement-only participants that rely on the exemption from the requirement to hold an Australian financial services licence under Corporations Regulation 7.6.01(1)(k) are not required to comply with the financial requirements set out above. To be eligible to be classified as a custodial settlement participant, ASX will require these participants to either demonstrate to ASX that they do meet these financial requirements, or alternatively enter into a guarantee with an entity that does (see below).

If a holder suffers loss as a result of fraud or misconduct, they would need to commence legal proceedings for recovery of their losses, with each such case to be determined on its facts.

3.1.2 Procure an entity that does meet the net tangible asset requirements to provide an unconditional and irrevocable guarantee in relation to unauthorised transfers

Alternatively, a custodial settlement participant may procure a third party guarantor that does meet the financial requirements set out in paragraph 3.1.1 above to provide a guarantee that would apply in the event that a custodial settlement participant is not legally entitled or authorised to transfer financial products.³ The guarantee must be:

- unconditional;
- irrevocable (at least in relation to transfers effected electronically without the lodgement of registrable transfer documents on the basis that the settlement participant was a custodial settlement participant); and
- in favour of holders, issuers or anyone else entitled to claim against the custodial settlement participant for an unauthorised transfer under the Corporations Regulations.

ASX intends to provide settlement-only participants with a standard form guarantee for this purpose modelled on similar guarantees provided under the ASX Operating Rules that relate to warrant issuers (refer to ASX Operating Rules S10.2(4)(d) and 10.2.2) and in relation to AQUA product issuers (refer ASX Operating Rules S10A.2(4)(d) & 10A.2.2).

Settlement-only participants that do not meet the qualifying criteria set out above will need to continue to comply with the existing registrable transfer document requirements. Issuers will also need to continue to receive a registrable transfer document and validate that the holder's name (and where relevant, address) in that document match the issuer's records for the relevant SRN prior to processing the transfer.

² These sections are introduced to the Corporations Act through Class Order [13/761] and Class Order [13/760].

³ See the warranty provided in Corporations Regulation 7.11.29 and associated indemnity in Corporations Regulation 7.11.32.

3.1.3 Identification of custodial settlement participants

ASX proposes that custodial settlement participants will be identified to issuers using the “Broker Non Broker Indicator” currently available today in CHES.

- Settlement participants that ASX has determined *are eligible* to be a custodial settlement participant will be identified by using the Broker Non Broker Indicator “B” on certain transfer and conversion messages.⁴
- Settlement only participants that *are not eligible* to be a custodial settlement participant would continue to be identified through the Broker Non Broker Indicator “N” (ie non-broker participant) indicating to issuers (and their registry) that a paper transfer document needs to be received and validated by the issuer before processing the transfer.

3.2. Require custodial settlement participants to undertake pre-transfer validation checks

ASX will introduce new requirements that will:

- require custodial settlement participants to undertake an additional check that the SRN and registration details they hold in respect of the transferor, match the issuer’s records in relation to that holder, prior to sending a CHES message requesting the transfer of financial products from an issuer sponsored holding to a CHES holding controlled by the custodial settlement participant; and
- prohibit custodial settlement participants from sending a CHES message (MT015) requesting the transfer of financial products from an issuer sponsored holding to a CHES holding controlled by the custodial settlement participant unless the SRN and registration details they hold in respect of the transferor match the issuer’s records in relation to that holder.

Custodial settlement participants will need to determine how they carry out such pre-transfer validation checks. However, ASX understands that these pre-transfer validations could occur in one of the following ways:

- the Issuers Sponsored Enquiry Facility in CHES – this facility enables a settlement participant to request a SRN from an issuer’s registry based on registration details provided by the settlement participant in a CHES message (MT451);
- paper 12A form (request for SRN) provided to the issuer’s registry; or
- through the issuer’s registry website.

A pre-transfer validation by a custodial settlement participant will provide for verification checks, similar to those currently required to be undertaken by issuers (generally through their share registries) prior to a transfer being authorised.

3.3. Align the treatment of custodial settlement participants with settlement participants that are ASX market participants in the manner contemplated in the Consultation Paper

ASX will align the treatment of custodial settlement participants with settlement participants that are also ASX market participants in the manner described in the Consultation Paper. That is, ASX Settlement Operating Rules 9.12.4 to 9.12.8 will apply to custodial settlement participants, and ASX Settlement Operating Rule 9.8.4 will no longer apply to custodial settlement participants.

The effect of these changes to the ASX Settlement Operating Rules will:

⁴ The CHES messages where the Broker Non Broker flag will be used to identify a custodial settlement participant are:

- 404 Issuer Sponsored to CHES Conversion Authorisation Request
- 408 Issuer Sponsored to CHES Transfer Authorisation Request
- 416 CHES to Issuer Sponsored Conversion
- 418 CHES to Issuer Sponsored Transfer
- 716 CHES Conversion Request to Issuer Sponsored Fund
- 719 Issuer Sponsored Fund to CHES Conversion Authorisation Request

- mean that custodial settlement participants will not be required to obtain a registrable transfer document prior to authorising a transfer;
- extend the existing warranties in ASX Settlement Operating Rule 9.12.5 to apply to custodial settlement participants, i.e. that:
 - the custodial settlement participant has the holder’s authority to effect a transfer; and
 - where the custodial settlement participant has received a registrable transfer document from a person other than the transferor, that it has the authority of the person specified as the transferor on that document and also has possession of that document; and
- extend the ancillary requirements for transfers set out in ASX Settlement Operating Rule 9.12.6 to 9.12.8 to custodial settlement participants, i.e.:
 - prohibit a custodial settlement participant from initiating a transfer if they have received a registrable transfer document from a person other than the transferor, unless they have also been authorised to effect the transfer by the transferor; and
 - require custodial settlement participants to carry out additional checks that the relevant financial products were deducted from the correct issuer sponsored holding and take rectification steps if this was not the case.

As part of this change, issuers will no longer be required to receive a registrable transfer document (and check that the transferor details on that transfer document match the holder details recorded on the issuer sponsored subregister for the relevant SRN) before authorising a transfer of an issuer sponsored holding to a CHES holding controlled by a custodial settlement participant.

3.4. Introduce subsequent message enhancements when implementing the CHES replacement system to facilitate efficiencies for other participants

ASX will seek to remove, for day 1 of the CHES replacement system, the requirement for other participants to provide a registrable transfer document to issuers for validation prior to a transfer being effected. This is to reflect that the introduction of ISO message enhancements through the CHES replacement system will require all participants to include a holder’s registration details on an instruction to transfer financial products from the issuer sponsored subregister to the CHES subregister. An issuer would then be able to validate those registration details in the ISO transfer instruction against holder details on the issuer sponsored subregister.

If a participant does not provide the holder’s registration details in the ISO instruction, the issuer will not be permitted to process that transfer.

4. Matters requiring clarification

ASX identified a number of common misconceptions about the operation of the ASX Settlement Operating Rules as they relate to transfers from the issuer to CHES subregister in responses to the Consultation Paper. To aid understanding, ASX has clarified some of these misconceptions below.

4.1. Issuer discretion to require a registrable transfer document before authorising a transfer

Three respondents (one industry group and two participants) considered that ASX should expressly prohibit issuers’ discretion to require a registrable transfer document before processing a transfer.

As explained below, issuers do not have such a discretion under the ASX Settlement Operating Rules.

- Where a transfer is initiated by a settlement-only participant, an issuer must not authorise a transfer unless the issuer has received a registrable transfer document signed by (or on behalf of) a holder.⁵ This is an existing

⁵ See ASX Settlement Operating Rules 9.8.4(b). Note that issuers are required to comply with other verification requirements under ASX Settlement Operating Rule 9.8.3 and 9.8.4(a).

requirement imposed on issuers and the ASX Settlement Operating Rules and does not provide issuers with any discretion to choose whether or not to comply.

- Where a transfer is initiated by a settlement participant that is a trading participant or a recognised market operator, there is no equivalent requirement for an issuer to receive a registrable transfer document before authorising a transfer.⁶ The ASX Settlement Operating Rules do not provide issuers with any discretion to require a registrable transfer document from such settlement participants. Under the proposal set out in this response to consultation, custodial settlement participants would also be treated in the same way.

4.2. Whether transfer documents are still required under ASX Settlement Operating Rules 9.12.5 and 9.12.6

One industry group respondent queried whether ASX Settlement Operating Rules 9.12.5 and 9.12.6 allowed settlement participants to advise their clients that a physical registrable transfer document is not required to effect an issuer to CHES sponsored transfer.

ASX notes that ASXSOR 9.12.5 and 9.12.6 only impose requirements in relation to registrable transfer documents if 9.12.6 applies, ie if the settlement participant takes possession of a registrable transfer document from a person other than the transferor.

In the case where a physical transfer document is received by the settlement participant from a person other than the transferor, those rules relevantly require that:

- the participant has been authorised to effect that transfer by the transferor (ie the holder) (refer to warranty to Issuer under 9.12.5(b)(i) and prohibition under 9.12.6)); and
- the settlement participant warrants to the issuer that it has possession of the physical transfer document (9.12.5(b)(ii)).

If no such physical transfer document is received then the above rules do not create an obligation that such physical transfer document be obtained.

It is up to the settlement participant to determine what it requires in order to meet the above requirements as to holder authority. Such authorisation obligations also apply under Corporations Regulations (including warranties, indemnities and offence provision under Corporations Regulations 7.11.29, 7.11.32 and 7.11.41).

4.3. Unfair treatment of settlement participants that are ASX trading participants

Two respondents (one an industry group and one a participant) thought that the proposal would mean that settlement participants that are ASX trading participants (or otherwise issuers) would be required to undertake holder name match checks while settlement-only participants would not be required to do so.

This is not what ASX has proposed. ASX has approached this change with the objective of treating all settlement participants equally, including expressly imposing on settlement-only participants the existing obligation on settlement participants that are trading participants to do post transfer name check under ASXSOR 9.12.7 and 9.12.8.

Under the amendments proposed above:

- settlement-only participants other than custodial settlement participants will continue to be required to comply with the registrable transfer document requirement, with issuers to undertake a name check pre-transfer - settlement participants that are trading participants are not subject to this requirement;
- custodial settlement participants are to be treated in the same way as settlement participants that are trading participants, in requiring a name check post transfer; and
- it is proposed that custodial settlement participants also be required to undertake such a name check pre-transfer, which would not be applicable to settlement participants that are trading participants.

⁶ Note that there are other verification requirements imposed on issuers and warranties provided by this class of settlement participant under ASX Settlement Operating Rules 9.8.3 and 9.12.5.

There is an existing requirement for a name check by issuers that applies to settlement participants that are trading participants under ASXOR 9.8.3(c) for conversions. This applies to all settlement participants. ASX is not proposing a change to this requirement.

4.4. Impact on the National Guarantee Fund (NGF)

Two respondents (one an industry group and one a participant) thought that the changes proposed would result in the NGF applying to transfers by settlement-only participants. These respondents were concerned that this would result in an increase in the NGF levy.

As noted in Part 2 of the Consultation Paper, the NGF does not apply to transfers made by settlement-only participants. As a result, these concerns are not relevant.

4.5. Applicability of Sponsorship Agreement

One share registry respondent asked for further information as to how many issuer sponsored to CHESS transfers are subject to the Sponsorship Agreement and Sponsorship Bond.

The proposed changes to the ASX Settlement Operating Rules are not contingent on the existence of protections under Sponsorship Agreements or the Sponsorship Bond, and these changes do not affect a holder's rights under such sponsorship arrangements. As set out in the Consultation Paper, the availability of recourse under these sponsorship arrangements is contingent on the facts of each case.

5. Next Steps

Subject to regulatory clearance, ASX intends to implement the proposed amendments to the ASX Settlement Operating Rules and Procedures outlined in this Response to Consultation on or around Q4 2019.