

## MAINTENANCE OF AN ORDERLY MARKET WHEN CLOSING OUT SETTLEMENT FAILURES

<b>The purpose of this Guidance Note</b>	<ul style="list-style-type: none"><li>• To assist participants to understand their settlement obligations for cash market transactions, including the compulsory close-out requirements in relation to failed settlements, and the need to maintain an orderly market when financial products are bought back to comply with those requirements</li></ul>
<b>The main points it covers</b>	<ul style="list-style-type: none"><li>• The settlement obligations of trading and clearing participants</li><li>• The close out obligations of settlement participants</li><li>• The requirement to maintain an orderly market when buying back a failed settlement shortfall on the ASX market</li><li>• Enforcement action for non-compliance with these obligations</li></ul>
<b>Related materials you should read</b>	<ul style="list-style-type: none"><li>• Nil</li></ul>

**History:** Guidance Note 13 issued 07/03/16. Previous versions of this Guidance Note were issued in 02/15 and as Guidance Note 37 under the ASX Market Rules in 02/09.

**Important notice:** ASX has published this Guidance Note to assist participants to understand and comply with their obligations under the ASX Operating Rules. It sets out ASX's interpretation of the ASX Operating Rules and how ASX is likely to enforce those rules. Nothing in this Guidance Note necessarily binds ASX in the application of the ASX Operating Rules in a particular case. In issuing this Guidance Note, ASX is not providing legal advice and participants should obtain their own advice from a qualified professional person in respect of their obligations. ASX may withdraw or replace this Guidance Note at any time without further notice to any person.

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## 1. Introduction

This Guidance Note is published by ASX Limited (ASX) to assist participants to understand their settlement obligations for cash market transactions, including the compulsory close out requirements in relation to failed settlements, and the need to maintain an orderly market when financial products are bought back to comply with those requirements.

## 2. Settlement obligations of trading and clearing participants

Trading participants generally have an obligation under ASX Operating Rule 3600 to ensure that each cash market transaction to which they are a party is settled on the second business day following the date that the transaction was created on or reported to the ASX market (that is, on T+2),<sup>1</sup> regardless of whether they clear and settle the transaction themselves or via a third party clearer.

Clearing participants likewise generally have an obligation under ASX Clear Operating Rule 4.20.1 to ensure that cash market transactions for which they are the nominated clearer are settled on the second business day following the date that the transaction was created on or reported to the relevant market.<sup>2</sup>

A failure by a trading participant or clearing participant to comply with these obligations constitutes a breach of the relevant Operating Rules, empowering ASX to take enforcement action against the participant under the ASX Enforcement and Appeals Rulebook.<sup>3</sup>

Trading and clearing participants are therefore expected to develop and implement adequate systems and controls to minimise the risk of breaching their settlement obligations. These should be reviewed on a regular basis to ensure they are operating effectively.

## 3. Close-out obligations of settlement participants

ASX Settlement Operating Rule 10.11.12 requires that if a failed settlement shortfall<sup>4</sup> exists in relation to:

- a source holding; or
- during an ex period, a cum entitlement balance for a source holding,

specified in a rescheduled batch instruction at the scheduled time on the second business day after the day on which the rescheduled batch instruction was originally scheduled for settlement (that is, in most cases,<sup>5</sup> on T+4), the delivering settlement participant must either:

<sup>1</sup> The second business day settlement deadline does not apply to forward delivery or deferred delivery transactions. In the case of forward delivery transactions, settlement must occur on the agreed forward date and, in the case of deferred delivery transactions, settlement must occur on the date specified by ASX (see ASX Operating Rules Procedure 3600).

<sup>2</sup> Again, the second business day settlement deadline does not apply to forward delivery or deferred delivery transactions (see ASX Clear Operating Rules Procedure 4.20.1).

<sup>3</sup> ASX Operating Rule 5100 and ASX Clear Operating Rule 4.20.4.

<sup>4</sup> As defined in ASX Settlement Operating Rule 2.13.

<sup>5</sup> The T+4 deadline does not apply to forward delivery or deferred delivery transactions: see notes 1 and 2 above.

- close out the failed settlement shortfall on the next business day (that is, in most cases,<sup>6</sup> on T+5) by purchasing the number of financial products of the relevant class equal to the failed settlement shortfall; or
- acquire under a securities lending arrangement the number of financial products of the relevant class equal to the failed settlement shortfall and deliver those financial products in batch settlement no more than two business days later (that is, in most cases,<sup>7</sup> by T+6).<sup>8</sup>

ASX Settlement Operating Rule 10.11.12 therefore generally requires a settlement participant to either buy back the shortfall by T+5, for settlement in the ordinary course on T+7, or to borrow the shortfall and deliver it into batch settlement by T+6.

Accordingly, unless a settlement participant has a high degree of confidence on T+5 that:

- it will be able to borrow the shortfall and deliver it into batch settlement by T+6; or
- there are other arrangements in place that will ensure that the shortfall will be eliminated by T+8,<sup>9</sup>

subject to the observations below about the need to maintain an orderly market, it should be taking the option on T+5 to buy back the shortfall.

If the settlement participant is also a participant of a market that trades in the relevant financial products, it may meet its buyback obligations by purchasing the required financial products itself on that market or it may instruct another market participant to do so on its behalf. If it is not a market participant, it will need to instruct a participant of a market that trades in the relevant financial products to purchase those financial products on its behalf.<sup>10</sup>

The intention behind ASX Settlement Operating Rule 10.11.12 is to ensure that settlement delays have a finite end date and are eliminated by T+8.

A failure by a settlement participant to comply with its close-out obligations under ASX Settlement Operating Rule 10.11.12 constitutes a breach of the ASX Settlement Operating Rules, empowering ASX to take enforcement action against the participant under the ASX Enforcement and Appeals Rulebook.<sup>11</sup> It also attracts the imposition of fail fees by ASX for each day that the settlement obligation remains outstanding.<sup>12</sup>

Compliance with ASX Settlement Operating Rule 10.11.12 is fundamental to the efficient operation of the ASX Settlement facility and any breach is generally regarded as a material one. Further, the fact that a client, a participant or any other party has suffered, or may suffer, a financial loss in buying back financial products to comply with that rule does not excuse non-compliance and is not considered by ASX to be a mitigating factor in relation to any such breach.

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<sup>6</sup> Again, the T+5 deadline does not apply to forward delivery or deferred delivery transactions: see notes 1 and 2 above.

<sup>7</sup> Again, the T+6 deadline does not apply to forward delivery or deferred delivery transactions: see notes 1 and 2 above.

<sup>8</sup> Settlement participants will receive a 554 close-out notification message via CHESSE after completion of the batch settlement on T+4 if there is a failed settlement shortfall that requires action under ASX Settlement Operating Rule 10.11.12.

Note that ASX Settlement Operating Rule 10.11.12 does not impose a close-out obligation on those participants whose obligations to deliver financial products are failed as a result of other participants failing to deliver financial products to them during the batch settlement process (see the note to ASX Settlement Operating Rule 10.11.12).

<sup>9</sup> For example, if the participant has lent the relevant financial products to a third party and it expects them to be returned by no later than T+8.

<sup>10</sup> As a practical matter, settlement participants who settle transactions for unrelated trading participants (that is, third party settlement participants) will generally impose a contractual obligation on those trading participants, in effect, to comply with ASX Settlement Operating Rule 10.11.12 as if they were the settlement participant.

<sup>11</sup> ASX Settlement Operating Rule 12.4.1.

<sup>12</sup> In cases where the settlement participant is settling for an unrelated trading participant, the settlement participant will usually on-charge any fail fees to the trading participant.

Settlement participants are therefore expected to develop and implement adequate systems and controls to minimise the risk of breaching their compulsory close-out obligations. These should be reviewed on a regular basis to ensure they are operating effectively.

#### **4. Maintenance of an orderly market**

Market participants buying back a failed settlement shortfall on the ASX market have a fundamental obligation under ASX Operating Rule 3101 and rule 5.9.1 of the ASIC Market Integrity Rules (ASX Market) 2010 not to do anything which results in a market for a product not being both fair and orderly.

Consequently, market participants should exercise due care and skill to avoid a disorderly market being created when buying back financial products to close out a failed settlement, particularly in less liquid financial products.

#### **5. Enforcement action**

If a failed settlement shortfall is not closed out by T+8, the matter will usually be referred to ASX Compliance for consideration of enforcement action against the participant or participants involved.

ASX appreciates that, in certain situations, there may be practical difficulties in buying back sufficient financial products to close out a settlement shortfall in a time frame that complies with ASX Settlement Operating Rule 10.11.12 and in a manner that does not interfere with orderliness of the market for that product. This may especially be so where the settlement shortfall is a relatively large position and the financial product in question is thinly traded.

Any participant that is concerned on this score should raise their concerns with ASX Compliance at the earliest opportunity and discuss available options.

ASX will take a participant's genuine attempts to meet their settlement obligations in a manner that does not interfere with the orderliness of the ASX market into favourable account when considering whether or not to pursue enforcement action against the participant for breaching the compulsory close-out obligations in the ASX Settlement Rules.