



# Transfers to the CHESS Subregister

## Consultation Paper

July 2018

## Invitation to comment

ASX is seeking submissions in response to this paper by 10 August 2018.

Submissions should be sent to:

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ASX prefers to receive submissions in electronic form.

If you would like your submission, or any part of it, to be treated as 'confidential', please indicate this clearly in your submission.

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## 1. Executive Summary

As part of the project to replace the Clearing House Electronic Subregister System (CHES), ASX undertook comprehensive stakeholder consultation to gain a better understanding of the functionality and services that users of CHES would like delivered by the new system.

This consultation process identified a number of business requirements that ASX plans to progress, which were set out in a consultation paper, *CHES Replacement: New Scope and Implementation Plan*, available here:

<https://www.asx.com.au/documents/public-consultations/ches-replacement-new-scope-and-implementation-plan.pdf>.

This includes the potential removal of the requirement under the ASX Settlement Operating Rules for settlement participants that are not ASX trading participants (**settlement-only participants**), to receive and provide to the issuer a transfer document signed by, or on behalf of, the holder (**registrable transfer document**) for the transfer of an issuer sponsored holding to a CHES holding controlled by the settlement participant (**transfer**).<sup>1</sup>

This requirement relates to the absence of protections for holders under the National Guarantee Fund (**NGF**) in respect of an unauthorised transfer by a settlement-only participant.

ASX proposes that any such removal of existing registrable transfer document requirements be contingent upon the making of amendments to the ASX Settlement Operating Rules to extend existing measures (which currently only apply to settlement participants that are also ASX trading participants) to settlement-only participants. These measures include:

- the warranty in favour of issuers that the holder has authorised the transfer; and
- the requirement to carry out additional checks that the relevant financial products were deducted from the correct issuer sponsored holding and to undertake rectification steps if this is not the case.

Any rule amendments are subject to the necessary regulatory clearances.

The amendments are not dependent on CHES replacement and so, if they are to proceed, would be implemented prior to go-live of the CHES replacement system.

This business requirement will streamline the process giving effect to transfers and align the treatment of settlement participants irrespective of whether they are also trading participants.

ASX has received support for this business requirement through the settlement enhancements working group convened as part of the CHES replacement consultation process to elicit input on business requirements, and also separately from issuers and their share registries.

ASX is now seeking any further feedback from stakeholders in respect of the potential amendments to the ASX Settlement Operating Rules to implement this business requirement, including to identify any additional issues not reflected in this paper that should be considered by ASX.

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<sup>1</sup> See ASX Settlement Operating Rules 9.8.4, 9.12.2 and 9.12.3.

## 2. Current requirement for a registerable transfer document

Currently, the requirements under the ASX Settlement Operating Rules to effect a transfer of financial products from an issuer sponsored holding to a CHESS holding controlled by a settlement participant differ between settlement participants that are ASX trading participants, and settlement-only participants.

- Settlement participants that are also ASX trading participants are required to send a CHESS MT015 message<sup>2</sup>, which is then processed by the issuer's share registry. Share registries process these transfers without any associated follow up paperwork.
- In addition to sending a CHESS MT015 message, settlement-only participants are required to receive, and provide to the issuer (generally through the issuer's share registry), a registerable transfer document, being a transfer document signed by or on behalf of the holder.<sup>3</sup>
- Issuers are similarly prohibited from authorising a transfer from an issuer sponsored holding to a CHESS holding controlled by a settlement-only participant, unless:
  - the issuer receives within 5 business days, a registerable transfer document purporting to be signed by or on behalf of the holder; and
  - the details of that transfer document match the issuer's records in relation to that holder.<sup>4</sup>

This requirement is reinforced by the Corporations Regulations which restrict issuers from effecting a transfer of financial products to a CHESS holding unless the transfer is in accordance with the ASX Settlement Operating Rules.<sup>5</sup>

These additional requirements are imposed on transfers involving settlement-only participants due to the absence of protections for holders under the National Guarantee Fund (**NGF**) in respect of unauthorised transfers by such settlement participants. NGF protection is only available in relation to the actions of "dealers", being persons that are market participants and in some circumstances, clearing participants.<sup>6</sup> In the context of an unauthorised transfer, a narrower definition of "dealer" applies, which refers to a market participant with an Australian nexus.<sup>7</sup>

There are thirty-eight settlement-only participants that are required to comply with the registerable transfer document requirement on a transfer from an issuer sponsored holding to a CHESS holding controlled by the participant. These participants are custodians, margin lenders, fund managers and other financial service providers.<sup>8</sup> They send, on average, approximately 600 CHESS MT015 messages a month to initiate transfers from issuer sponsored holdings to CHESS holdings they control. Approximately 75%<sup>9</sup> of these transfers are initiated by custodians who perform custodial services for wholesale clients. The remaining transfers are initiated by margin lenders, fund managers or other financial service providers who may be acting for both wholesale and retail clients.

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<sup>2</sup> A CHESS MT015 message is required to include the identifier of the settlement participant (PID) transmitting the message, the SRN for the issuer sponsored holding from which the financial products are to be deducted, the HIN for the CHESS holding to which the financial products are to be added, the number of financial products to be transferred, and some additional details if it is a foreign to foreign allocation.

<sup>3</sup> ASX Settlement Operating Rules 9.12.2 and 9.12.3

<sup>4</sup> ASX Settlement Operating Rule 9.8.4. In sample transfer documents viewed by ASX, the transferor details provided consisted of the transferor's name and SRN, or alternatively name, address and SRN. Accordingly the matching of records by an issuer (generally through its share registry) for the purpose of this rule would be expected to involve checking that the transferor's name and SRN (or alternatively name, address and SRN) in the transfer document matches the holder's name (and in some circumstances, address) recorded on the issuer sponsored subregister for that SRN.

<sup>5</sup> Under Corporations Regulation 7.11.35 an issuer must not register or give effect to such a transfer unless the transfer is a "proper ASTC transfer". To be a "proper ASTC transfer" the transfer must be in accordance with the ASX Settlement Operating Rules or a transfer that ASX Settlement, in accordance with the ASX Settlement Operating Rules, determines to comply substantially with the applicable provisions of the operating rules and to be taken to be a "proper ASTC transfer" (refer to Corporations Regulations 1.0.02).

<sup>6</sup> Refer to Corporations Regulations 7.5.03, 7.5.19, 7.5.24, 7.5.26, 7.5.59 and 7.5.68.

<sup>7</sup> Refer to Corporations Regulations 7.5.53 and 7.5.59.

<sup>8</sup> These include wealth management advisors and professional trustee service providers.

<sup>9</sup> Based on data for the months of February 2018 to April 2018.

### 3. Potential amendments to the ASX Settlement Operating Rules

To implement the business requirement, ASX is considering amending the ASX Settlement Operating Rules to:

- remove the requirement for settlement-only participants to receive and provide to the issuer a registrable transfer document signed by or on behalf of the holder in order to effect a transfer of an issuer sponsored holding to a CHES holding controlled by the settlement participant; and
- remove the requirement for issuers to have received a registerable transfer document purporting to be signed by or on behalf of the holder before authorising a transfer of an issuer sponsored holding to a CHES holding controlled by a settlement-only participant. As a consequence, issuers will also no longer be required to check that the transferor details on that transfer document match the holder details recorded on the issuer sponsored subregister for the relevant SRN.

ASX proposes that any such removal of existing registrable transfer document requirements would be contingent upon the making of amendments to the ASX Settlement Operating Rules to:

- extend the existing warranties to issuers specified in ASX Settlement Operating Rule 9.12.5 that currently are only provided by settlement participants that are also ASX trading participants, i.e. that:
  - the settlement participant has the holder’s authority to effect a transfer; and
  - where the 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,

so as to also be provided by settlement-only participants;<sup>10</sup> and

- extend the ancillary requirements for transfers specified in ASX Settlement Operating Rules 9.12.6 to 9.12.8 that currently only apply to settlement participants that are also ASX trading participants, i.e. for:
  - transferor authority where a registrable transfer document was provided to the settlement participant by a person other than the transferor;
  - additional checks that the relevant financial products were deducted from the correct issuer sponsored holding; and
  - rectification steps if this was not the case,

so as to also apply to settlement-only participants.

Any rule amendments are subject to the necessary regulatory clearances.

If the ASX Settlement Operating Rules are amended to remove the obligation on settlement participants to obtain and provide to the issuer a registrable transfer document, those settlement participants will still need to take their own view as to what they require in order to be satisfied that they:

- can provide the warranties under the ASX Settlement Operating Rules (described above), and the statutory warranties and indemnities under the Corporations Regulations 2001 (Cth),<sup>11</sup> that they have the authority of the holder to effect a transfer; and

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<sup>10</sup> If the amendments proceed, the warranty provided under ASX Settlement Operating Rule 9.12.5 relating to a conversion of financial products (i.e. a movement between the issuer sponsored and CHES subregisters without any change in legal ownership) will also be extended to apply to settlement-only participants, replacing the equivalent warranty provided under ASX Settlement Operating Rule 9.12.1.

<sup>11</sup> Refer to Corporations Regulations 7.11.29 and 7.11.32.

- do not contravene the Corporations Regulations by including their PID in a message to effect a transfer that is not authorised by the transferor.<sup>12</sup>

If the obligation is removed, it will still be open to a settlement participant to continue to require a registrable transfer document for this purpose.

## 4. Rationale for removal of registrable transfer document requirement

### 4.1. Alignment of treatment of settlement participants

The potential amendments will align the treatment of settlement participants for transfers of issuer sponsored holdings to CHES holding controlled by the settlement participant, regardless of whether they are also an ASX trading participant.

This includes the requirement to receive and provide to the issuer a registrable transfer document signed by or on behalf of the holder as well as warranties, checks and rectification steps provided for under the ASX Settlement Operating Rules in relation to such transfers.

### 4.2. Streamline process for giving effect to transfers

The potential amendments will streamline the process for giving effect to such transfers. As a result, holders, issuers and settlement-only participants will realise the following benefits.

- Holders will benefit from transfer requests being processed in a timelier manner, due to the efficiencies set out below.
- Settlement-only participants will benefit from:
  - reduced processing times in actioning client instructions; and
  - removal of duplication of steps to evidence client authorisation for a transfer, as settlement participants will not be required to send holders a transfer document for signature when they have already received the holder's authorisation to the transfer by other means which they determine appropriate (e.g. via a SWIFT message including the instructing holder's SRN).
- Issuers (through their share registry) will benefit from the removal of manual processes, as issuers' share registries will not need to:
  - wait for registrable transfer documents; and
  - validate the transferor details on the transfer document against the holder details recorded on its issuer sponsored subregister,prior to actioning CHES messages for such transfers; or
  - have to store registrable transfer documents received as part of that process.

### 4.3. Protections for holders

The proposed extension to settlement-only participants of the checks and rectification requirements under ASX Settlement Operating Rules 9.12.7 and 9.12.8 will provide protection measures to identify and reverse an unauthorised transfer undertaken by a settlement participant. These measures allow for similar verification steps to those currently required to be undertaken by issuers (generally through their share registries) prior to authorising a transfer on the basis of the details on the registrable transfer document. This is because:

- upon notification that the transfer from an issuer sponsored holding to a CHES holding controlled by the settlement participant has been effected, the settlement participant will be required to check that the name and

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<sup>12</sup> Refer to Corporations Regulations 7.11.41.

address of the holder for the SRN recorded on the issuer sponsored subregister,<sup>13</sup> match the details of the person seeking to undertake the transfer through the settlement participant as the holder for that holding; and

- if those details do not match, the settlement participant is required to liaise with the issuer to take such steps as to rectify the error.

Settlement participants will need to verify the identity of persons seeking to effect transfers of financial products in respect of a SRN through the settlement participant.<sup>14</sup> They will also need to ensure that they have the authority of the relevant holder in respect of that SRN to effect that transfer. As indicated below, failure to do so could represent a breach of warranties provided under the Corporations Regulations (and ASX Settlement Operating Rule 9.12.5 (proposed to be extended to settlement-only participants)), leaving a settlement participant liable to indemnify affected parties, and may also constitute an offence under the Corporations Regulations.

In addition:

- There will be no impact on the scope and application of statutory warranties and indemnities under the Corporations Regulations. The Corporations Regulations provide a statutory warranty from the settlement participant whose participant identification number (**PID**) is included in messages for the transfer of financial products, including that the settlement participant was authorised by the transferor to effect the transfer. If the settlement participant breaches this warranty, the Corporations Regulations make the settlement participant liable to indemnify certain third parties (including the issuer and transferor).<sup>15</sup> These warranties and indemnities will continue to apply as they do now if this business requirement is implemented.
- It will still be an offence under the Corporations Regulations for settlement participants to include their PID in an electronic message to effect a transfer of financial products if they are not authorised to effect the transfer.<sup>16</sup>
- There will be no change to a holder's rights against a settlement participant where a Sponsorship Agreement is in place between these parties i.e, in the event of a fraudulent transfer:
  - any contractual rights that may be available for breach of the sponsorship agreement;<sup>17</sup> or
  - any compensation that may be available through the settlement participant's sponsorship bond,<sup>18</sup>the applicability of which will continue to depend on the circumstances of each case.

As referred to in Section 5 below, ASX is however seeking feedback on whether the amendments set out in Section 3 are considered to adversely impact holder protections, and if so, whether additional requirements for:

- settlement-only participants to continue to provide to issuers, holder details currently contained in transfer documents (being at a minimum, name and SRN); and
- issuers to check those details against its issuer sponsored holding records prior to processing a transfer,

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<sup>13</sup> Such name and address details are included in the CHES message (MT405) to the settlement participant notifying it that the transfer has been effected. These details reflect the delivering registration details included by the issuer (generally through its share registry) in the message it sent to authorise the relevant transfer.

<sup>14</sup> Including as part of any applicable know your customer (KYC) obligations.

<sup>15</sup> Refer to Corporations Regulations 7.11.29 and 7.11.32.

<sup>16</sup> Refer to Corporations Regulations 7.11.41.

<sup>17</sup> Settlement participants must include in each sponsorship agreement a provision to the effect that the settlement participant will not initiate any transfer into or out of a participant sponsored holding without the express authority of the holder (refer to ASX Settlement Operating Rule 7.2.2(h)).

<sup>18</sup> If a Settlement Participant that is not subject to the NGF or other approved compensation arrangements for an AMO under Part 7.5 Division 3 of the Corporations Act establishes and maintains CHES holdings sponsored by the participant, it is required to lodge a \$500,000 sponsorship bond with ASX Settlement. This bond is intended to apply in circumstances where a holder sponsored by that participant suffers a loss as result of the participant's contravention of the ASX Settlement Operating Rules and there is no real prospect of the holder obtaining adequate compensation otherwise than under the sponsorship bond. Refer to ASX Settlement Operating Rule 4.9.

would address the basis for considering the amendments to adversely impact on holder protections.

The introduction of these additional requirements could impact the availability of some of the process efficiencies referred to in 4.2 above, e.g. the issuer would need to continue to maintain manual processes to await receipt of and check holder details where a transfer involved a settlement-only participant.

## 5. Stakeholder feedback requested by ASX

ASX has received support for this business requirement from stakeholders that formed part of the settlement enhancements working group convened as part of the CHES replacement consultation process to elicit input on business requirements.<sup>19</sup> ASX has also separately engaged and received positive feedback from issuers and their share registries.

ASX invites further feedback from stakeholders on the following questions:

- Do you support the implementation of the rule amendments set out in Section 3?
- If you do not support these amendments, is this because you consider the amendments set out in Section 3 will adversely impact on holder protections? If so:
  - please provide reasons for your answer; and
  - comment on whether the introduction of the following additional requirements would change your answer:
    - a settlement-only participant to provide to the issuer written details of the holder's name for the relevant SRN; and
    - the issuer to 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.
- Are there any issues that have not been identified in this paper that should be considered by ASX? If so, please provide details.

Written submissions must be provided to ASX by 10 August 2018.

If you would like your submission, or any part of it, to be treated as 'confidential', please indicate this clearly in your submission. Submissions marked 'confidential' may still be shared with relevant regulators.

### Acronyms

ASX	Australian Securities Exchange
CHES	Clearing House Electronic Subregister System
HIN	CHES Holder Identification Number
KYC	Know your customer (alternatively, know your client)
NGF	National Guarantee Fund
PID	Participant Identification Code
SRN	Securityholder Reference Number

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<sup>19</sup> The settlement enhancements working group was one of six working groups convened as part of this process. The working groups comprised clearing and settlement participants, custodians, issuers' share registries, approved market operators, issuers, investor industry associations, and their representatives.