

USING A SETTLEMENT OR ACCUMULATION ACCOUNT FOR CUSTODIAL PURPOSES

<p>The purpose of this Guidance Note</p>	<ul style="list-style-type: none"> To assist participants to understand the limited circumstances in which a settlement or accumulation account may be used for custodial purposes
<p>The main points it covers</p>	<ul style="list-style-type: none"> When ASX's consent is required for a participant to hold financial products for custodial purposes in a settlement or accumulation holding The circumstances in which ASX will provide such consent The conditions ASX is likely to apply when providing such consent How to apply for ASX's consent
<p>Related materials you should read</p>	<ul style="list-style-type: none"> ASX Settlement Operating Rules Guidance Note 4: <i>Waivers and In-Principle Advice</i>

History: Guidance Note 12 issued 07/03/16. Previous versions of this Guidance Note were issued in 02/15 and under the ASTC Settlement Rules as Guidance Note 10 in 12/04.

Important notice: ASX has published this Guidance Note to assist participants to understand and comply with their obligations under the ASX Settlement Operating Rules. It sets out ASX's interpretation of the ASX Settlement 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 Settlement 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 Settlement Pty Limited ("ASX") to assist participants to understand the limited circumstances in which a settlement holding¹ or accumulation holding² may be used for "custodial purposes", that is, any purpose other than facilitating the execution of outstanding orders or the clearing and settlement of outstanding transactions.³

2. The need for ASX consent under Rule 6.3.4(d)

ASX Settlement Operating Rule 6.3.4(d) provides that a settlement participant must not use a settlement holding or an accumulation holding for custodial purposes unless it either obtains ASX's written consent or an exception in Rule 6.3.5 applies.

ASX Settlement Operating Rule 6.3.5 provides that a settlement participant may not hold the same financial products in a settlement holding or an accumulation holding for a period greater than 2 business days except, in the case of financial products in an accumulation holding, if:

- a current sell order from a client in respect of those financial products remains outstanding;
- the financial products comprise AQUA products and a request for redemption in respect of those financial products remains outstanding;
- the financial products were acquired by the participant on the instructions of a client and that client has not paid the purchase price for those financial products; or
- each of the following apply:
 - the constitution of the issuer of the financial products does not permit holdings of less than a marketable parcel;
 - only some of the financial products acquired by the participant on the instructions of the client have been transferred to the participant; and
 - transfer by the participant of those financial products to a holding would contravene the prohibition on holdings of less than a marketable parcel under Rule 8.10.2.⁴

¹ A "settlement holding" means a holding of financial products in CHESS for which the holder record is a "settlement account". A "settlement account" means a holder record maintained in CHESS by a participant for the purpose of facilitating settlement of transactions in approved financial products with other participants. See ASX Settlement Operating Rule 2.13.1.

² An "accumulation holding" means a holding of financial products in CHESS for which the holder record is an accumulation account. An "accumulation account" means a holder record maintained by a settlement participant for the purpose of facilitating settlement of transactions in approved financial products with non-participant clients. See ASX Settlement Operating Rule 2.13.1.

³ See the definition of "Custodial Purposes" in ASX Settlement Operating Rule 2.13.1.

⁴ ASX Settlement Operating Rule 8.10.2 provides that a participant must not initiate a transfer of financial products if, by giving effect to that transfer, a CHESS or issuer sponsored holding of less than a marketable parcel will result, unless the holding of less than a

3. The policy objectives behind Rule 6.3.4(d)

Rule 6.3.4(d) serves two main policy objectives:

- investor protection – it supports the participant’s underlying fiduciary obligations:
 - to account to clients for whose assets it is responsible on a timely basis; and
 - to minimise the co-mingling of client and house assets any more than is necessary for the operation of the daily CHESSE settlement batch; and
- operational efficiency – it assists the participant in tracking the client and house assets under its charge.

Both of these objectives are aided by the obligation of a settlement participant to conduct daily reconciliations of the holdings in its accumulation account⁵ and to notify ASX if there is a deficiency of financial products in its accumulation account.⁶

4. The circumstances in which ASX will provide consent under Rule 6.3.4(d)

ASX will not provide a consent under Rule 6.3.4(d) if, in its opinion, a lessening of investor protection may result.⁷

ASX acknowledges that the investor protection and operational efficiency objectives that underpin Rule 6.3.4(d) may be met by other measures. Where a participant can demonstrate to ASX’s satisfaction that the account arrangements it proposes will meet these objectives and also the requirements of section 984B and regulation 7.8.07 of the Corporations Act 2001 (Cth),⁸ ASX will consider giving its consent to the use of a settlement or accumulation holding for custodial purposes.

In ASX’s view, there is no reduction in investor protection where financial products are registered in the name of a nominee company that meets the requirements for a nominee company in ASX Clear Operating Rule 4.11.1, namely, a company that:

- is incorporated in the Commonwealth of Australia with a name that includes the word “nominee”;
- has a constitution that precludes the nominee company from owning any financial products or other property except cash beneficially; and
- is a directly held legally and beneficially wholly-owned subsidiary of the participant which is operated by the participant.

ASX therefore will usually consent to a settlement holding or accumulation holding being used for custodial purposes in circumstances where the relevant financial products are registered in the name of a nominee company that meets the criteria above and the relevant holding contains financial products held solely for clients or solely for the participant and its related entities (ie, where there is no co-mingling of client and house assets).

5. The conditions ASX will typically apply to a consent under Rule 6.3.4(d)

Where ASX gives consent to a participant under Rule 6.3.4(d) to use a settlement holding or an accumulation holding for custodial purposes, the settlement participant must comply with any terms or conditions imposed by

marketable parcel is expressly permitted under an issuer’s constitution or the transfer establishes a new settlement holding or accumulation holding.

⁵ ASX Settlement Operating Rule 6.3A.3 and the related Procedure.

⁶ ASX Settlement Operating Rules 6.3A.4.

⁷ See the concluding sentence to ASX Settlement Operating Rule 6.3.4(d).

⁸ Referred to in this Guidance Note as the “Corporations Act”. Section 984B and regulation 7.8.07 regulate how client property can be dealt with by a financial services licensee.

ASX. Any failure by the participant to do so will constitute a breach of Rule 6.3.4(d) and potentially lead to enforcement action against the participant.⁹ It may also lead to ASX revoking its consent.¹⁰

ASX will generally impose conditions on any consent it grants to a participant to use a settlement holding or an accumulation holding for custodial purposes requiring the participant to:

- obtain a written consent from each client for whom financial products are held by the participant or a nominee company in the custodial holding for legal title to the client's financial products to be held in that way and, if the client's financial products potentially may be used to settle the obligations of another client in the event of a delivery failure by that other client, an express consent for that to occur as well;
- maintain accurate records of the beneficial owners and their entitlements in the custodial holding;
- provide regular reports to beneficial owners regarding their entitlements in the custodial holding;
- conduct, and maintain records of, daily reconciliations of the beneficial entitlements in the custodial holding against the participant's client records; and
- advise ASX immediately if it is unable to reconcile the actual number of financial products in the custodial holding against the participant's client records.¹¹

ASX will invariably reserve the right to withdraw or modify the consent at any time.¹²

ASX may impose such further conditions on a participant's use of a settlement or accumulation holding for custodial purposes as it considers appropriate in the circumstances.¹³ For example, in some cases, ASX has imposed conditions:

- requiring all financial products in the relevant account to be held on a custodial basis by, and in the name of, a specified nominee company on behalf of the participant's clearing clients;
- prohibiting the participant from holding financial products beneficially owned by the participant or a related entity in the account, except cash;
- requiring the participant to provide to ASX a copy of the supervisory controls and compliance procedures it has established in relation to the account; and
- requiring a periodic review by the participant's compliance group or an external party of the functioning of the supervisory and compliance procedures relating to the account.

6. How to request ASX's consent under Rule 6.3.4(d)

The process for requesting a consent under Rule 6.3.4(d) is essentially the same as for requesting in-principle advice set out in ASX Settlement Operating Rules Guidance Note 4 *Waivers and In-Principle Advice*.

A request for consent under Rule 6.3.4(d) must be in writing and addressed to the General Manager, Participants Compliance.

The request should set out in reasonable detail:

- the proposed account arrangements giving rise to the need for the consent;

⁹ See the second sentence to ASX Settlement Operating Rule 6.3.4(d).

¹⁰ ASX Settlement Operating Rule 3.2.3.

¹¹ If the custodial holding is held in an accumulation account, the participant will already have this obligation under ASX Settlement Operating Rules 6.3A.3 and 6.3A.4: see notes 5 and 6 above and the accompanying text.

¹² Even if ASX does not expressly reserve the right to withdraw or modify its consent, it has the power to do so under ASX Settlement Operating Rule 3.2.3.

¹³ ASX Settlement Operating Rule 3.2.4.

- the reason for seeking the consent, including an explanation of the commercial ramifications if the consent is not granted;
- an outline of the supervisory controls and compliance procedures the participant intends to have in place in relation to the relevant account or accounts; and
- evidence that the account arrangements it proposes will meet the policy objectives of Rule 6.3.4(d) mentioned above and also the requirements of section 984B and regulation 7.8.07 of the Corporations Act.

This information should be provided in sufficient detail to enable ASX to fully assess the application and to be satisfied that giving the consent requested will not compromise the underlying policy objectives of Rule 6.3.4(d). ASX may reject or defer consideration of an application for a consent that does not include this information in sufficient detail.

The onus is on the applicant to establish that there is a sufficiently strong commercial case to justify the granting of the consent and that granting the consent:

- is consistent with the statutory obligations imposed on ASX as the operator of a licensed settlement facility;
- will not undermine the principles on which the ASX Settlement Operating Rules are based¹⁴ or the policy underlying Rule 6.3.4(d); and
- will not otherwise adversely affect the reputation of the markets and facilities that ASX operates.

¹⁴ The fundamental principle underlying all ASX Settlement Operating Rules is that the ASX Settlement facility should be fair and efficient.