

## SECTION 4

### CLEARING AND SETTLEMENT OF MARKET CONTRACTS RELATING TO SECURITIES TRADED ON THE EQUITY MARKET OF THE CSE

*For the avoidance of doubt, the reference to the term "Securities" in this section of the Rules shall only be a reference to Securities traded on the equity market of the CSE as referred to in the Trading Rules of the CSE including but not limited to shares or any other instrument conferring or representing a legal or beneficial ownership interest in a Listed Entity including any rights, options or interests thereto and units or any other such instrument issued to the investors under an investment scheme as defined in the CSE Rules.*

#### PART A: MARGIN REQUIREMENTS AND MARKET COLLATERAL

##### 4.1 Margin Requirements

- (i) The Clearing House shall impose the margin requirements set out in this Section on all Clearing Members of the Clearing House in respect of all Market Contracts carried out on the Equity Market of the CSE on each Trade Day, other than the following:
  - (a) A Market Contract for sale of Securities which does not result in a Short Position;
  - (b) An Excluded Crossing;
  - (c) A Market Contract carried out on the Buy-in Board of the CSE; and
  - (d) A Market Contract in Foreign Currency denominated Securities executed on the CSE.
- (ii) The total margin requirement applicable for each Clearing Member shall comprise of the following:
  - (a) Base margin requirement; and
  - (b) Additional margin requirements (where applicable).

##### 4.1.1 Base Margin Requirement

- (i) Each Clearing Member shall at all times maintain collateral to satisfy the base margin requirement determined by the Clearing House from time to time as morefully set out in Rule 4.2. The base margin requirement shall be computed based on the quarterly average daily purchase turnover of each Clearing Member.
- (ii) The base margin requirement applicable to each Clearing Member shall be reviewed by the Clearing House on a quarterly basis on the first (1<sup>st</sup>) Market Day of each calendar quarter, based on the average daily purchase turnover of each such Clearing Member in the preceding calendar quarter. Any increase or decrease in the base margin requirement applicable to a Clearing Member shall be notified, in writing, to such Clearing Member by the Clearing House.

- (iii) If there is an increase in the base margin requirement applicable to a Clearing Member, such Clearing Member shall comply with such increased margin requirement in accordance with Rule 4.2.
- (iv) If there is a decrease in the base margin requirement applicable to a Clearing Member, the excess collateral maintained by such Clearing Member with the Clearing House shall be refunded to the Clearing Member in accordance with Rule 4.2.

#### **4.1.2 Additional Margin Requirements**

- (i) If the base margin requirement set out in Rule 4.1.1 is insufficient to satisfy the total margin requirement of such Clearing Member in respect of Market Contracts carried out on a particular Trade Day, the Clearing House shall impose additional margin requirements on Clearing Members as set out in Rule 4.1.2.
- (ii) The additional margin requirements shall comprise of the:
  - (a) Initial margin requirement; and,
  - (b) Variation margin requirement;which shall be computed based on the methodology determined by the Clearing House from time to time and notified to the Clearing Members.
- (iii) The additional margin requirement (if any) shall be communicated to the relevant Clearing Members by the Clearing House at the end of each Trade Day (T).
- (iv) The Clearing Member shall take necessary steps to comply with such additional margin requirement in accordance with Rule 4.2.

## **4.2 Market Collateral**

### **4.2.1. General**

- (i) Clearing Members shall, at all times, ensure compliance with the margin requirements set out in Rule 4.1 by maintaining sufficient collateral with the Clearing House in accordance with this Rule 4.2.
- (ii) Clearing Members may obtain collateral from the relevant Client/s of the Clearing House who are Account Holders of the CDS - Central Depository, to the extent of the margin requirements arising from the Market Contracts carried out by such Account Holder/s, in satisfying the total margin requirements applicable to such Clearing Member.

### **4.2.2 Form of Collateral**

Clearing Members shall furnish collateral to the Clearing House in the form of cash and/or an irrevocable and unconditional bank guarantee obtained from a commercial bank licensed by the CBSL, acceptable to the Clearing House.

#### 4.2.3 Manner of Furnishing Collateral

- (i) Subject to Rule 4.2.3 (iii), Clearing Members shall furnish the required collateral to the Clearing House in fulfilment of margin requirements set out in Rule 4.1 in the following manner:
  - (a) The base margin requirement shall be initially fulfilled by the Clearing Member by furnishing the collateral by 14:30 hours on the second Market Day immediately following the date of notification by the Clearing House requesting for the furnishing of such collateral.
  - (b) In respect of any increase to the base margin requirement, the Clearing Member shall furnish the collateral by 14:30 hours on the second Market Day immediately following the date of notification by the Clearing House of the increase to the base margin requirement.
  - (c) In respect of any additional margin requirement, the Clearing Member shall furnish the collateral by 10:30 hours on the Market Day immediately following the date of notification by the Clearing House of the additional margin requirement.
- (ii) Any cash collateral furnished by a Clearing Member in fulfilment of margin requirements set out in these Rules shall be deposited into an account maintained by the Clearing House in a settlement bank for the specific purpose of margin utilization.
- (iii) In the event of Custodian Trades, a Clearing Member that is a Custodian Bank (hereinafter referred to as a 'Custodian Clearing Member') shall furnish Market Collateral to the Clearing House in the manner set out below:
  - (a) Each Custodian Clearing Member shall furnish to the Clearing House collateral in fulfilment of the margin requirements applicable to Market Contracts affirmed by such Custodian Clearing Member in terms of Rule 4.8. The Custodian Clearing Member shall furnish such collateral to the Clearing House by 10.30 hours on T+2.
  - (b) In the event of a rejection of a purchase transaction by a Custodian Clearing Member in terms of Rule 4.8, the Stockbroker, through whom such Market Contract for purchase of Securities was carried out (hereinafter referred to as a Stockbroker Clearing Member), shall furnish collateral to the Clearing House in fulfilment of the margin requirements applicable to such Market Contract by 10.30 hours on T+2.
  - (c) In the event a Custodian Clearing Member affirms a Market Contract for purchase of Securities which was initially rejected by such Custodian Clearing Member in accordance with the Rule 4.8 (v), such Custodian Clearing Member shall forthwith furnish the collateral in fulfilment of the

margin requirements applicable to such Market Contract in accordance with Rule 4.1 by 10.30 hours on T+2.

#### **4.2.4 Requirement to Replenish Collateral**

If the Clearing House utilizes, in full or in part, any collateral furnished by a Clearing Member for a settlement failure, such Clearing Member shall replenish the collateral utilized by the Clearing House forthwith, upon same being notified to the Clearing Member by the Clearing House.

#### **4.2.5 Returning of Excess Collateral and Interest**

- (i) Any cash collateral furnished by a Clearing Member in respect of a Market Contract, to the extent not utilized for the purpose of settling all payment obligations of the Clearing Member and/or its client in respect of such Market Contract (excess cash collateral), shall be returned by the Clearing House upon a written request being made by the Clearing Member, provided however that if the Clearing Member has not provided adequate collateral in respect of its other Trades, the Clearing House may retain, from such excess cash collateral, any amount as is necessary for the fulfilment of the outstanding margin requirement of the Clearing Member.
- (ii) Any interest accruing on excess cash collateral shall also be paid to the Clearing Member with the return of the collateral, upon deducting an administration fee by the Clearing House which shall be determined by the Clearing House from time to time.

#### **4.2.6 Rights of the Clearing House in relation to the Collateral Deposited with the Clearing House**

- (i) The Clearing House shall have a first and paramount lien and charge over the collateral deposited with the Clearing House by a Clearing Member for the due settlement of the following payment obligations of the Clearing Member under these Rules;
  - (a) any sums due and payable by such Clearing Member to any other Clearing Member;
  - (b) any sum payable by clients of such Clearing Member pursuant to these Rules including compensation for settlement failures and/or failed Market Contracts; and/or
  - (c) any and all sums payable by such Clearing Member to the Clearing House, CDS - Central Depository, CSE and SEC including fees, commissions, charges and/or dues payable by such Clearing Member.
- (ii) The Clearing House shall be entitled to use such collateral deposited by a Clearing Member to defray the payments identified in Rule 4.2.6 (i).

### 4.3 Non-Compliance with Rules 4.1 and 4.2

If a Clearing Member fails to comply with the margin requirements imposed by the Clearing House in accordance with Rules 4.1 and 4.2, the Clearing House shall initiate the following action against such Clearing Member:

(i) Imposition of fines

(a) The Clearing House shall impose fines as set out below:

<b>Instance of Non-Compliance</b>	<b>Fine (Rs.)</b>
On the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees One Hundred Thousand (Rs. 100,000/-).
On the second (2 <sup>nd</sup> ) occurrence within one (1) year from the date of the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees Two Hundred Thousand (Rs. 200,000/-).
On the third (3 <sup>rd</sup> ) occurrence, which is within one (1) year from the date of the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees Five Hundred Thousand (Rs. 500,000/-).

(b) The fines shall be charged from the Clearing Members based on a schedule issued by the Clearing House as at end of the applicable month. The Clearing Member shall pay the relevant amount as indicated in the schedule to the Clearing House within Two (2) Market Days from the date of the issue of such schedule.

(ii) Commencement of Disciplinary Proceedings

If a Clearing Member fails to comply with the margin requirements imposed by the Clearing House in accordance with Rule 4.1 and Rule 4.2 on more than three (3) separate occasions within any given period of twelve (12) months, the Clearing House shall, in addition to the fines fee stipulated in Rule 4.4(i)(a), commence disciplinary proceedings against such Clearing Member in terms of Section 8 of these Rules.

## **PART B: SETTLEMENT OF MARKET CONTRACTS**

### **4.4 SETTLEMENT OF MARKET CONTRACTS DENOMINATED IN LKR**

#### **4.4.1 Inter - Clearing Member Settlement of Funds**

- (i) The inter - clearing member settlement of funds for Market Contracts carried out on the Equity Market of the CSE shall take place by 10.30 hours on the Settlement Date, i.e. third (3<sup>rd</sup>) Market Day after the Trade Day (T+3), through the appointed settlement bank/s as per the Settlement Schedules issued by the Clearing House. The inter - clearing member settlement shall be completed by 10.30 hours on the settlement date.

Provided however that; in respect of Securities traded on the Buy-in Board of the CSE, the inter - clearing member settlement of funds shall take place by 10.30 hours on the first (1<sup>st</sup>) Market Day after the Trade day ("Buy-In Board Settlement Date").

- (ii) A Stockbroker Clearing Member shall ensure that sufficient Cleared Funds are available in the settlement bank account by 09.30 hours on the Settlement Date to settle payment obligations arising out of Market Contracts to be cleared and settled by such Clearing Member based on the Settlement Schedule issued by the Clearing House.

Provided however, in respect of Securities traded on the Buy-in Board of the CSE, the Stockbroker Clearing Member shall ensure that sufficient Cleared Funds are available in the settlement bank account by 09.30 hours on the Buy-In Board Settlement Date to settle payment obligations arising out of the said Market Contracts to be cleared and settled by such Clearing Member.

- (iii) A Custodian Clearing Member shall make available sufficient Cleared Funds in the settlement bank account by 09.30 hours on the Settlement Date to settle the payment obligations arising out of Market Contracts to be cleared and settled by such Custodian Clearing Member based on the Settlement Schedule issued by the Clearing House.

Provided however that, in respect of Securities traded on the Buy-in Board of the CSE, the Custodian Clearing Members shall ensure that sufficient Cleared Funds are available in the settlement bank account by 09.30 hours on the Buy-In Board Settlement Date to settle payment obligations arising out of the said Market Contracts to be cleared and settled by such Custodian Clearing Members.

- (iv) The Clearing House shall debit or credit itself and the Clearing Members with the amounts payable and receivable in accordance with these Rules.
- (v) The buying Clearing Member shall ensure that each buyer makes available, the required Cleared Funds in respect of Market Contracts so as to enable the buying Clearing Member to meet its fund settlement obligations within the time period prescribed in these Rules.

- (vi) If the buyer fails to make available the Cleared Funds referred to in Rule 4.4.1 (v), the buying Clearing Member which is a Stock Broker, may at its absolute discretion, recover interest commencing from the day after the Settlement Date up to the date of final settlement provided such interest shall not exceed 0.1% per day, provided such Clearing Member settled such Market Contract.
- (vii) Selling Clearing Member who is a Stock Broker:
  - a) shall ensure that Cleared Funds are made available to the seller on the Settlement Date of the Market Contract, unless the seller has requested the Clearing Member, in writing, to retain the sale proceeds. If for any reason the sale proceeds have not been made available to the Seller by the Stock Broker on the Settlement Date without a written request from the seller as aforesaid, the seller shall be entitled to interest from the day after the Settlement Date on the outstanding amount at 0.1% per day from the Selling Clearing Member.
  - b) can make settlements to the seller either by cheques or electronic fund transfers to the seller's bank account. If payment is made to sellers by way of cheques they shall be duly crossed as 'Account Payee'. If the seller requests that the crossing to be cancelled, the selling Clearing member shall obtain a written request from the seller and such request must be authorized by the Chief Executive Officer of such Clearing Member.
  - c) No cash cheques shall be issued to clients.

For the purposes of this Rule, 'Cleared Funds' shall mean funds that are realized and available for drawing in the respective settlement bank.

#### **4.4.2 Settlement of Securities**

- (i) A selling Clearing Member shall ensure that a Market Contract for the sale of Securities does not result in a Short Position as at the end of the Trade Day on which such Market Contract is executed.
- (ii) A selling Clearing Member failing to discharge its obligation under Rule 4.4.2 (i) shall, in order to facilitate the settlement of the Market Contract;
  - (a) purchase the shortfall of Securities for the sell Market Contract under reference on the Buy-In Board of the CSE on or before T+2 on behalf of the seller; or
  - (b) otherwise procure the required number of Securities to cover such shortfall by 15.00 hours on T+2.
- (iii) The selling Clearing Member shall ensure that the required number of Securities are made available in the seller's Client Account by 15.00 hours on T+2 for delivery of such Securities to the buyer's Client Account on the Settlement Date.

- (iv) A Clearing Member making a sell order of Securities on the Buy-In Board of the CSE shall ensure that the required number of Securities are held in the Cleared Balance of the seller's Client Account at the time such sell order is placed.
- (v) The settlement of Securities by delivery thereof, pursuant to a Market Contract, shall take place on the Settlement Date, only upon the receipt of confirmation of the settlement of funds from the appointed settlement bank.

#### **4.4.3 Non-compliance with Rule 4.4.2 (i)**

- (i) If a selling Clearing Member fails to discharge its obligation under Rule 4.4.2 (i) on more than three (3) separate occasions within any given period of six (6) months or on five (5) separate occasions within any given period of one (1) year, the Clearing House shall impose and the Clearing Member shall pay a fine of Rs. 50,000 for each instance of non-compliance occurring thereafter.

Provided however, that if the selling Clearing Member fails to discharge its obligation under rule 4.4.2 (i) due to:

- (a) a local client of a Custodian Clearing Member directly placing an order through the internet trading facility provided to such local client by a Stockbroker Firm; or,
- (b) a Short Position being created pursuant to a rejection of a trade by a Custodian Clearing Member,

on more than five (5) separate occasions within any given period of six (6) months or on seven (7) separate occasions within any given period of one (1) year, the Clearing House shall impose and the Clearing Member shall pay a fine of Rs. 50,000 for each instance of non-compliance occurring thereafter.

- (ii) The fine shall be charged from the Clearing Member based on a schedule issued by the Clearing House at the end of the applicable month. The Clearing Member shall pay the relevant amount indicated in the schedule to the Clearing House within Two (2) Market Days from the date of the issue of such schedule.

#### **4.4.4 Trade Affirmations/Rejections by Custodian Banks**

- (i) Subject to Rule 4.4.4 (iii), Market Contracts carried out on behalf of Account Holders registered through a Custodian Clearing Member shall be affirmed or rejected by the respective Custodian Clearing Member by 14.00 hours on T+1, in the format prescribed by the Clearing House from time to time. Provided however, that such affirmation or rejection of a Market Contract shall not be applicable in respect of Excluded Crossings and Market Contracts carried out on the Buy-In Board of the CSE.



- (ii) If a Custodian Clearing Member fails to affirm a Market Contract carried out by a Trading Participant prior to the stipulated time period referred to in this Rule for any reason whatsoever, such failure to affirm shall be considered as a rejection of the Market Contract by the Custodian Clearing Member.
- (iii) In the event of a rejection of a Market Contract by a Custodian Clearing Member, the Clearing House shall issue a revised Settlement Schedule by T+2 and substitute the Custodian Clearing Member with the Stockbroker/Stock Dealer Clearing Member which carried out such Market Contract in the capacity of a Trading Participant of the CSE for the purpose of settlement of the Market Contract concerned on the Settlement Date.
- (iv) A Custodian Clearing Member may subsequently affirm a Market Contract, which was initially rejected by such Custodian Clearing Member in terms of this Rule, prior to 12.00 hours on T+2 with the concurrence from the Trading Participant which carried out such Market Contract, provided that;
  - (a) the Trading Participant which carried out the Market Contract (who is also the Stockbroker/Stock Dealer Clearing Member) makes a request in writing to the Clearing House for the reversal of the obligations relating to such Market Contract from the Stockbroker Clearing Member to the Custodian Clearing Member; and,
  - (b) the Custodian Clearing Member satisfying all margin requirements set out in Rule 4.1 in the manner set out in Rule 4.2.3 (iii).
- (v) In the event of an affirmation by a Custodian Clearing Member in accordance with Rule 4.4.4 (iv), the Clearing House shall facilitate the reversal of obligations relating to such Market Contract from the Stockbroker Clearing Member to the Custodian Clearing Member and an amended Settlement Schedule shall be sent by T+2 to the relevant Clearing Member and the settlement banks by the Clearing House.

#### **4.4.5 Settlement Failure**

The Rules set out in Part C (Default Handling) of Section 4 of these Rules shall be applicable to a settlement failure in contravention of these Rules.

### **4.5 SETTLEMENT OF MARKET CONTRACTS DENOMINATED IN FOREIGN CURRENCIES**

#### **4.5.1 Inter - Clearing Member Settlement of Funds - Equity**

- (i) The inter-Clearing Member settlement of funds for Shares denominated in Foreign Currency traded on the CSE, shall take place by 12.30 hours on the Settlement Date, i.e. T+3, through the appointed settlement bank/s as per the Settlement Schedules issued by the Clearing House. The inter-Clearing Member settlement shall be completed by 12.30 hours on the Settlement Date.

- (ii) A Custodian Clearing Member's obligation on any Settlement Date to make payment in respect of Market Contracts carried out by such Clearing Member in respect of Shares denominated in Foreign Currency shall be set off against such Custodian Clearing Member's entitlement to receive funds on the Settlement Date for such Market Contracts carried out by the Clearing Member.
- (iii) The Clearing House shall issue, on each Market Day, a Settlement Schedule, which shall reflect the debits and credits that have been entered into the Custodian Clearing Member's account and the net amount to be settled by each Custodian Clearing Member on a particular Settlement Date in respect of transactions relating to Shares denominated in Foreign Currency.
- (iv) The Custodian Clearing Member shall, for Market Contracts executed on the CSE pertaining to Shares denominated in Foreign Currency, make available sufficient Cleared Funds in the Settlement Bank by 10.30 hours on the Settlement Date to settle the payment obligations arising out of transactions carried out by such Custodian Clearing Member based on the Settlement Schedule issued by the Clearing House.
- (v) The Clearing House shall debit or credit itself and the Clearing Members with the amounts payable and receivable in accordance with these Rules.

#### **4.5.2 Settlement of Securities - Equity**

- (i) The selling Custodian Clearing Member shall ensure that the required number of Foreign Currency denominated Shares are available in the seller's Client Account on the Trade Date. The Clearing House shall, by arrangement with the CDS – Central Depository, ensure that such quantity of Shares are locked-in the seller's Client Account in order for delivery of such Shares to the buyer's Client Account on the Settlement Date.
- (ii) The settlement of Foreign Currency denominated Shares by delivery thereof, pursuant to a Market Contract, shall take place on the Settlement Date referred to in Rule 4.5.2 (i), only upon the receipt of confirmation of the settlement of funds from the appointed Settlement Bank.

#### **4.5.3 Trade Affirmations/Rejections by Custodian Banks**

- (i) Market Contracts in Foreign Currency denominated Shares shall be affirmed or rejected by the respective Custodian Clearing Member by 14.30 hours on T+1, in the format prescribed by the Clearing House from time to time.
- (ii) If a Custodian Clearing Member fails to affirm a Market Contract carried out by a Trading Participant prior to the stipulated time period referred to in Rule 4.5.3 (i) for any reason whatsoever, such failure to affirm shall be considered as a rejection of the Market Contract by the Custodian Clearing Member.

- (iii) In the event of a rejection of a Market Contract of Shares denominated in Foreign Currency, such rejection shall result in a cancellation of such Market Contract and the Clearing House shall notify the CSE to cancel such Market Contract.
- (iv) In the event, a Market Contract in Foreign Currency denominated Shares is cancelled in accordance with Rule 4.5.3 (iii), the Clearing House shall issue an amended Settlement Schedule to the relevant Custodian Clearing Members and the Settlement Banks.

#### **4.5.4 Fund Settlement Failure**

In the event of a fund settlement failure by a Custodian Clearing Member in respect of a Market Trade in Foreign Currency denominated Shares, the Clearing House shall initiate enforcement action against such Custodian Clearing Member in accordance with Part C (Default Handling) of Section 4.

## **PART C: DEFAULT HANDLING**

*Part C shall be applicable in respect of all Trades executed on the equity market of the CSE as referred to in the Trading Rules, except Excluded Crossings as defined in these Rules and Market Contracts executed on the Buy-in Board of the CSE.*

### **4.6 Responsibility of the Clearing Member**

The integrity and stability of the Securities market is dependent on the due settlement by a Clearing Member of each Market Contract to be cleared and settled by such Participant. The failure to do so will result in loss of public trust and confidence in the credibility of the market. Accordingly, as set out in Part C of Section 4 of these Rules, it is the sole obligation and the responsibility of the Clearing Member to ensure that each Market Contract is duly settled on the Settlement Date. This fundamental premise with regard to settlement of Market Contracts will accordingly form the basis for the provisions of this Part C of Section 4.

### **I. Failures in Settlement of Market Contracts**

#### **4.7 Default of Payment**

(a) If a Clearing Member:

- (i) is aware that the fund settlement in respect of a Market Contract on the Settlement Date is likely to be defaulted due to a potential failure by the buyer to make sufficient Cleared Funds available to such Clearing Member; and/or
- (ii) is unable to reasonably ascertain that the fund settlement in respect of a Market Contract on the Settlement Date will take place,

such Clearing Member shall, by 15.00 hours on T + 2, notify the Clearing House, in writing, that such Market Contract is likely to be defaulted. Upon the receipt of such notification, the Clearing House shall isolate such Market Contract and issue an amended Settlement Schedule, excluding the obligations arising out of such Market Contract. The amended Settlement Schedule shall be sent to the respective Clearing Members and the appointed settlement banks for settlement on the next Market Day.

Provided however that provisions of this Rule 4.7 (a) shall not be construed in any manner howsoever to be in derogation of the obligation and responsibility of the Clearing Member to ensure due settlement of each Market Contract as set out in Rule 4.6.

For the avoidance of any doubt and without prejudice to the provisions of Rule 4.9, the Clearing House shall be entitled to take disciplinary action against any Clearing Member who fails to issue notification or issues any notification in violation of the provisions of this Rule 4.7(a).

- (b) The Clearing House shall, by arrangement with the CDS - Central Depository, ensure that the Securities relating to a Trade that is isolated and removed from the Settlement

Schedule in terms of Rule 4.7(a) are not transferred from the seller's Client Account to the buyer's Client Account in the CDS - Central Depository on the Settlement Date.

- (c) If Market Contracts are isolated in terms of Rule 4.7(a) and where such Market Contracts are;
  - (i) denominated in LKR, such Market Contracts shall be deemed to be failed Trades on the Settlement Date;
  - (ii) denominated in foreign Currency, the Clearing House will notify the CSE to cancel such the Market Contracts;

and the Clearing House shall communicate an amended settlement schedule to all relevant Clearing Members.

- (d) The buyer of a failed Trade referred to in Rule 4.7 (c)(i), shall be liable to pay compensation to (i) the seller of such failed Trade and (ii) the seller's Clearing Member, which shall be computed based on a formula determined by the Clearing House and notified to the Clearing Members from time to time and published on the CDS website.

The compensation payable in respect of a failed Trade as computed in terms of the said formula shall be deemed to be a genuine pre-estimate of the losses and damages of (i) the seller and (ii) the seller's Clearing Member, arising from the failure of the Trade.

- (e) The compensation payable by the buyer to the seller and the seller's Clearing Member in respect of a failed trade in terms of this Rule 4.7 (c)(i), shall be settled by the buyer's Clearing Member to the seller's Clearing Member on the applicable date/s as determined and communicated to the Clearing Members by the Clearing House.
- (f) The payment by the buyer through the buyer's Clearing Member of the compensation referred to in this Rule 4.7 (e) in full to (i) the seller through the seller's Clearing Member and (ii) the seller's Clearing Member shall be a full and complete discharge of the obligations of the buyer in respect of a failed Trade referred to in this Rule 4.7 (c)(i).
- (g) Upon receipt of the compensation in respect of a failed Trade from the buyer's Clearing Member, the seller's Clearing Member shall ensure that the compensation payable to the seller is credited to the bank account of the seller on the applicable date/s as determined and communicated to the Clearing Members by the Clearing House.

#### **4.8 Default of Delivery of Securities**

- (a) If the number of Securities held in the Cleared Balance of the Client Account of the seller maintained in the CDS - Central Depository through the seller's Depository Participant is insufficient to settle a Market Contract in full on the Settlement Date, such Market Contract shall be settled to the extent possible by the delivery of the entirety of the Securities held in such Client Account to the buyer. The delivery shall take place by the debiting of such Securities from the seller's Client Account in the CDS - Central Depository and the

crediting of the Securities to the buyer's Client Account upon the settlement of funds in respect of the Securities available in the seller's Client Account for delivery to the buyer as aforesaid.

- (b) The Seller's Clearing Member shall ensure that, the seller who has failed to deliver all or part of the Securities required for settlement of a Market Contract on the Settlement Date (even where the failure of the seller to procure sufficient Securities was due to the unavailability of Securities for purchase on the Buy-In Board and/or any other reason) shall be liable to pay compensation to (i) the buyer and (ii) the buyer's Clearing Member, which shall be computed based on a formula to be determined by the Clearing House and notified to the Clearing Members from time to time.
- (c) The Seller's Clearing Member shall ensure that, the seller who has failed to deliver all or part of the Securities required for settlement of a Market Contract on the Settlement Date shall, in addition to and over and above the compensation referred to in Rule 4.8(b), be liable to compensate the buyer for entitlements accruing to those Securities arising from any corporate actions relating to such Securities that the buyer, as the recipient of such Securities would have become entitled to and/or received but for the delivery failure.

The method of computation of compensation payable in respect of each such corporate action shall be determined by the Clearing House and notified to the Clearing Members from time to time and published on the CDS website.

- (d) The compensation payable by the seller to the buyer and the buyer's Clearing Member in terms of this Rule 4.8 shall be settled by the seller's Clearing Member to the buyer's Clearing Member on the applicable date/s as determined and communicated to the Participants by the Clearing House.

The compensation payable in terms of this Rule 4.8 as computed in terms of the formula determined by the Clearing House shall be deemed to be a genuine pre-estimate of the losses and damages of (i) the buyer and (ii) the buyer's Clearing Member arising from the failure to deliver the relevant Securities.

- (e) The payment by the seller through the seller's Clearing Member of the compensation referred to in this Rule 4.8 in full to (i) the buyer through the buyer's Clearing Member and (ii) the buyer's Clearing Member shall be a full and complete discharge of the obligations of the seller in respect of a failed Trade referred to in this Rule 4.8.
- (f) Upon receipt of the compensation in terms of this Rule 4.8 from the seller's Clearing Member, the buyer's Clearing Member shall ensure that the compensation payable to the buyer is credited to the bank account of the buyer on the applicable date/s as determined and communicated to the Clearing Members by the Clearing House.

## II. Liabilities of a Clearing Member in respect of a Settlement Failure

### 4.9 Default of fund settlement

If a Clearing Member defaults in settlements of funds in respect of any Market Contract on a particular Settlement Date in terms of Rule 4.4.1 for any reason whatsoever including any failure by the buyer/s to make sufficient Cleared Funds available to the Clearing Member, (i) such Clearing Member shall pay to the Clearing House a fine to be determined by the Clearing House at its discretion from time to time and (ii) the Clearing House shall take the following action in enforcement of the provisions of these Rules.

(A) In respect of a Stockbroker/Stock Dealer Clearing Member:

- (a) The Clearing House shall not clear or settle any Market Contracts for purchase of Securities of such Stockbroker/Stock Dealer Clearing Member on behalf of its client/s and on its own account, for a period of fifteen (15) Market Days and shall notify the CSE and CDS - Central Depository, with immediate notice to the market.

Provided however, the Clearing House shall clear or settle Market Contracts for sale of Securities of the Stockbroker/Stock Dealer Clearing Member subject to such Market Contracts being carried out with a Cleared Balance on its client/s account/s and its own account.

- (b) The Clearing House shall publish a notice in all three (03) languages in national newspapers stating the non-compliance with the applicable Rules and the enforcement action taken by the Clearing House in respect of the Stockbroker/Stock Dealer Clearing Member concerned.
- (c) If such Stockbroker/Stock Dealer Clearing Member fails to meet its outstanding settlement obligations by the expiry of the fifteenth (15<sup>th</sup>) Market Day period referred to in Rule 4.9(A)(a), the Clearing House shall, in addition to the above, not clear or settle Market Contracts for sale of Securities of such Stockbroker/Stock Dealer Clearing Member on behalf of its clients and on its own account and shall notify the CSE and the CDS – Central Depository thereof.
- (d) The Clearing House shall publish a notice in all three (03) languages in national newspapers notifying the public of the enforcement action taken in respect of the Stockbroker/Stock Dealer Clearing Member concerned.
- (e) Notwithstanding the enforcement action referred to herein, the Stockbroker/Stock Dealer Clearing Member shall continue to honour its obligations with regard to fund settlement to other Clearing Members.
- (f) The Clearing House shall notify the CSE, CDS – Central Depository and the SEC regarding the enforcement action initiated against the Stockbroker/Stock Dealer Participant in terms of Section 10 of these Rules.

- (g) The Clearing House shall initiate disciplinary action against the Stockbroker/Stock Dealer Participant concerned in terms of Section 8 of these Rules.

(B) In respect of a Custodian Clearing Member pertaining to Trades in Shares denominated in LKR:

- (a) The Clearing House shall prohibit the Custodian Clearing Member from carrying out any clearing and settlement functions through the Clearing House with immediate effect and shall notify the CSE and the CDS – Central Depository thereof.
- (b) The Clearing House shall publish a notice in all three (03) languages in national newspapers notifying the public of the fund default of the Custodian Clearing Member and the corresponding enforcement action taken by the Clearing House.
- (c) Notwithstanding the prohibition referred to herein, the Custodian Clearing Member shall continue to honor its obligations with regard to fund settlement to other Participants.

The Clearing House shall notify the CSE and CDS – Central Depository regarding the enforcement action initiated against the Custodian Clearing Member in terms of Section 10 of these Rules.

(C) In respect of a Custodian Clearing Member pertaining to Trades in Shares denominated in Foreign Currency:

- (i) The Clearing House shall impose and the Custodian Clearing Member shall pay a processing fee of USD 500 or equivalent thereof for each instance of a fund settlement failure by a Custodian Clearing Member on a given Settlement Date.

The Custodian Clearing Member shall pay such processing fee to the Clearing House within Two (2) Market Days from the date of imposition of such processing fee,

- (ii) If a Custodian Clearing Member fails to meet the fund settlement obligations in terms of Rule 4.5.1 of these Rules,
  - a. on two (2) separate occasions within any given period of six (6) months; or,
  - b. on three (3) separate occasions within any given period of one (1) year,

the Clearing House shall, in addition to the processing fee referred to in Rule 4.9(C)(i), prohibit such Custodian Clearing Member from carrying out any Clearing House functions with immediate effect for a period of three (3) Market Days.



- (iii) The Clearing House shall publish a notice on the website of the CDS notifying the public of the fund settlement default by the Custodian Clearing Member and the corresponding enforcement action taken by the Clearing House
- (iv) Notwithstanding the prohibition referred to in item (b), the Custodian Clearing Member shall continue to honor its obligations with regard to fund settlement to other Clearing Members.

#### 4.10 Securities Default

If a Clearing Member fails to ensure that the required number of Securities are made available in the seller/s Client Account with the CDS - Central Depository on the Settlement Date in terms of Rule 4.4.2, the Clearing House shall initiate the following action against such Clearing Member:

(a) Imposition of fines:

(i)

<b>Instance of Non-Compliance</b>	<b>Fine (Rs.)</b>
On the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees One Hundred Thousand (Rs.100,000/-).
On the second (2 <sup>nd</sup> ) occurrence within one (1) year from the date of the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees Two Hundred Thousand (Rs. 200,000/).
On the third (3 <sup>rd</sup> ) occurrence, which is within one (1) year from the date of the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees Five Hundred Thousand (Rs. 500,000/-);

(ii) Provided that if a Clearing Member fails to ensure that the required number of Securities are made available in the seller/s Client Account with the CDS - Central Depository on the Settlement Date in terms of Rule 4.4.2 due to:

- (i) A local client of a Custodian Clearing Member directly placing an order through the internet trading facility provided to such local client by a Stockbroker Firm; or,
- (ii) A Short Position being created pursuant to a rejection of a trade by a Custodian Clearing Member,

the Clearing House shall initiate the following action against such Clearing Member:

<b>Instance of Non-Compliance</b>	<b>Fine (Rs.)</b>
On the third (3 <sup>rd</sup> ) occurrence within one (1) year from the date of the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees One Hundred Thousand (Rs.250,000/-).
On the fourth (4 <sup>th</sup> ) occurrence within one (1) year from the date of the first (1 <sup>st</sup> ) occurrence	The Clearing House shall charge a fine of Rupees Two Hundred Thousand (Rs. 500,000/-).

(b) Other Enforcement Action

In addition to the fines stipulated in Rule 4.10 (a), if a Clearing Member fails to ensure that the required number of Securities are made available in the seller/s Client Account with the CDS - Central Depository on the Settlement Date on four (4) separate occasions within any period of one (1) year in terms of Rule 4.10(a)(i), or five (5) separate occasions within any period of one (1) year in terms of Rule 4.10 (a)(ii) the Clearing house shall;

- (i) prohibit such Clearing Member from carrying out any clearing and settlement functions through the Clearing House on behalf of its clients and on its own account, for a period of three (3) Market Days and notify the CDS - Central Depository thereof

and,

- (ii) publish a notice on the websites of the CSE and the CDS stating the noncompliance with the applicable Rules and the enforcement action taken by the Clearing House against the Clearing Member.

**4.11 Utilization of the Settlement Guarantee Fund**

- (i) In the event of a default of fund settlement by a Clearing Member and the Market Collateral furnished to the Clearing House is insufficient to satisfy the settlement obligations of such Clearing Member, such Clearing Member may obtain funding from the Settlement Guarantee Fund established by the SEC and the CSE to meet outstanding settlement obligations, subject to the conditions stipulated by the Settlement Guarantee Fund.
- (ii) If a Clearing Member obtains funding from the Settlement Guarantee Fund referred to in Rule 4.11, the Clearing Member shall replenish the said Fund within the time period to be determined by the Clearing House in consultation with the SEC.

- (iii) For the avoidance of doubt, any refusal or rejection by the Settlement Guarantee Fund to provide funding to the Clearing Member pursuant to a request being made therefor by the Clearing Member, for any reason whatsoever, shall not relieve the Clearing Member from its outstanding settlement obligations in any manner whatsoever.
- (iv) The Clearing House may, require the Clearing Members to contribute to a Settlement Guarantee Fund to be established by the Clearing House in the manner specified by the Clearing House from time to time.