

## **SECTION 11**

### **DEFAULT HANDLING**

This Section 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 transactions executed on the Buy-in Board of the CSE.

#### **11.1 Responsibility of the Participant**

The integrity and stability of the Securities market is dependent on the due settlement by a Participant of each Trade executed 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 Section 10 of these Rules, it is the sole obligation and the responsibility of the Participant to ensure that each Trade executed by the Participant is duly settled on the Settlement Date. This fundamental premise with regard to settlement of Trades will accordingly form the basis for the provisions of this Section 11.

#### **A. Failures in Settlement of Trades**

#### **11.2 Default of Payment**

- (a) In the event a Participant,
  - (i) is aware that the fund settlement in respect of a Trade 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 Participant; and/or
  - (ii) is unable to ascertain beyond reasonable doubt that the fund settlement in respect of a Trade on the Settlement Date will take place,

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

Provided however that provisions of this Rule 11.2 (a) shall not be construed in any manner howsoever to be in derogation of the obligation and responsibility of the Participant to ensure due settlement of each Trade executed by the Participant as set out in Rule 11.1 above.

For the avoidance of any doubt and without prejudice to the provisions of Rule 11.4 below, the CDS shall be entitled to take disciplinary action against any Participant who fails to issue notification or issues any notification in violation of the provisions of this Rule 11.2 (a).

- (b) The Securities relating to a Trade that is isolated and removed from the Settlement Schedule in terms of Rule 11.2(a) above shall not be transferred by the CDS from the seller's Client Account to the buyer's Client Account on the Settlement Date.

- (c) All isolated Trades referred to in Rule 11.2(a) above shall be deemed to be failed Trades on the Settlement Date.
- (d) The buyer of a failed Trade shall be liable to pay compensation to (i) the seller of such failed Trade and (ii) the seller's Participant, which shall be computed based on a formula determined by the CDS and notified to the Participants from time to time.

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 Participant, arising from the failure of the Trade.

- (e) The compensation payable by the buyer to the seller and the seller's Participant in terms of this Rule 11.2 shall be settled by the buyer's Participant to the seller's Participant on the applicable date/s as determined and communicated to the Participants by the CDS.
- (f) The payment by the buyer through the buyer's Participant of the compensation referred to in this Rule 11.2 in full to (i) the seller through the seller's Participant and (ii) the seller's Participant shall be a full and complete discharge of the obligations of the buyer in respect of a failed Trade referred to in this Rule 11.2.
- (g) Upon receipt of the compensation in respect of a failed Trade from the buyer's Participant, the seller's Participant 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 Participants by the CDS.

### **11.3 Default of Delivery of Securities**

- (a) In the event the number of Securities held in the Cleared Balance of the Client Account of the seller maintained in the CDS through the seller's Participant is insufficient to settle a Trade in full on the Settlement Date, such Trade 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 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 who has failed to deliver all or part of the Securities required for settlement of a Trade 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 Participant, which shall be computed based on a formula to be determined by the CDS and notified to the Participants from time to time.
- (c) A seller who has failed to deliver all or part of the Securities required for settlement of a Trade on the Settlement Date shall, in addition to and over and above the compensation referred to in Rule 11.3(b) above, 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 CDS and notified to the Participants from time to time.

- (d) The compensation payable by the seller to the buyer and the buyer's Participant in terms of this Rule 11.3 shall be settled by the seller's Participant to the buyer's Participant on the applicable date/s as determined and communicated to the Participants by the CDS.

The compensation payable in terms of this Rule 11.3 as computed in terms of the formula determined by the CDS shall be deemed to be a genuine pre-estimate of the losses and damages of (i) the buyer and (ii) the buyer's Participant arising from the failure to deliver the relevant Securities.

- (e) The payment by the seller through the seller's Participant of the compensation referred to in this Rule 11.3 in full to (i) the buyer through the buyer's Participant and (ii) the buyer's Participant shall be a full and complete discharge of the obligations of the seller in respect of a failed Trade referred to in this Rule 11.3.
- (f) Upon receipt of the compensation in terms of this Rule 11.3 from the seller's Participant, the buyer's Participant 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 Participants by the CDS.

## **B. Liabilities of a Participant in respect of a Settlement Failure**

### **11.4 Default of fund settlement**

In the event a Participant defaults in settlements of funds in respect of any Trade on a particular Settlement Date in terms of Rule 10.2 of these Rules due to any reason whatsoever including any failure by the buyer/s to make sufficient Cleared Funds available to the Participant, (i) such Participant shall pay to the CDS an administrative fee to be determined by the CDS at its discretion from time to time and (ii) the CDS shall take the following action in enforcement of the provisions of these Rules.

#### **(A) In respect of a Stockbroker Participant:**

- (a) The CDS shall not give effect to any purchase transactions of such Stockbroker Participant on behalf of its client/s and on its own account, for a period of fifteen (15) Market Days.  
Provided however, the CDS shall give effect to carry out sale transactions of Stockbroker Participant subject to such transactions being carried out with a Cleared Balance on its client/s account/s and its own account.
- (b) The CDS 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 CDS in respect of the Stockbroker Participant concerned.

- (c) In the event such Stockbroker Participant fails to meet its outstanding settlement obligations by the expiry of the fifteenth (15<sup>th</sup>) Market Day period referred to in Rule 11.4(A)(a) above, sale transactions of such Stockbroker Participant on behalf of its clients and on its own account shall also not be given effect to by the CDS.
- (d) The CDS 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 Participant concerned.
- (e) Notwithstanding the enforcement action referred to herein, the Stockbroker Participant shall continue to honour its obligations with regard to fund settlement to other Participants.
- (f) Account Holders who hold Securities with a Stockbroker Participant in default may transfer their Securities from such Participant to any other Participant of their choice. The Account Holders may do so only after the settlement of any outstanding dues or payables to such Stockbroker Participant in default. Such transfer of Securities shall be carried out in terms of Section 7 of the Rules.
- (g) The CDS shall initiate disciplinary action against the Stockbroker Participant concerned in terms of Section 17 of these Rules.

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

- (a) The CDS shall prohibit the Custodian Bank from carrying out any CDS functions with immediate effect.
- (b) The CDS shall publish a notice in all three (03) languages in national newspapers notifying the public of the fund default of the Custodian Bank and the corresponding enforcement action taken by the CDS.
- (c) Notwithstanding the prohibition referred to herein, the Custodian Bank shall continue to honor its obligations with regard to fund settlement to other Participants.
- (d) Account Holders who maintain Securities in the CDS through such Custodian Bank may, in view of the prohibition imposed on the Custodian Bank, obtain the services of the CDS through any other Participant of their choice. The Account Holders may do so only upon the settlement of any outstanding dues or payables to such Custodian Bank in default. Change of Participant in the CDS shall be carried out in terms of Section 7 of the Rules.

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

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

The Custodian Participant shall pay such processing fee to the CDS within two (2) Market Days from the date of imposition of such processing fee.

- (b) In the event a Custodian Participant fails to meet the fund settlement obligations in terms of Rule 10.3.1 of these Rules,
  - (i) on two (2) separate occasions within any given period of six (6) months; or,
  - (ii) on three (3) separate occasions within any given period of one (1) year,

the CDS shall in addition to the processing fee referred to in Rule 11.4(C)(a) above, prohibit such Custodian Participant from carrying out any CDS functions with immediate effect for a period of three (3) Market Days.

- (c) The CDS shall publish a notice in the website of the CDS notifying the public of the fund settlement default by the Custodian Participant and the corresponding enforcement action taken by the CDS.
- (d) Notwithstanding the prohibition referred to in Rule 11.4 (C) (b) above, the Custodian Participant shall continue to honor its obligations with regard to fund settlement to other Participants.

## **11.5 Securities Default**

- (i) In the event a Participant fails to ensure that the required number of Securities are made available in the seller/s Client Account on the Settlement Date in terms of Rule 10.2.2 of these Rules, on two (2) separate occasions within any given period of six (6) months; or, on three (3) separate occasions within any given period of one (1) year, whichever comes first, the CDS shall take enforcement action in respect of a CDS Participant for a Securities Default in terms of Rule 11.5 (ii) below.

Provided however, in the event a Participant fails to ensure that the required number of Securities are made available in the Seller/s Client Account on the Settlement date in terms of Rule 10.2.2 of these Rules due to:

- (a) A local client of a Custodian Participant 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 Participant,

The CDS shall take enforcement action in respect of such Participant for a Securities Default in terms of Rule 11.5 (ii) below, only upon the lapse of four (4) separate occasions within any given period of six (6) months or on seven (7) separate occasions within any given period of one (1) year, whichever comes first (as applicable).

- (ii) The CDS shall:
  - (a)
    - 1) in the respect of a Stockbroker Participant, not give effect to any transactions of such Stockbroker Participant on behalf of its client/s and on its own account, for a period of three (3) Market Days.
    - 2) in the respect of a Custodian Bank, prohibit such Participant from carrying out any CDS functions with immediate effect, for a period of three (3) Market Days.
  - (b) publish a notice on the websites of the CSE and CDS stating the non-compliance with the applicable Rules and the enforcement action taken by the CDS in respect of such Participant.
  - (c) in the event of any further instance of a securities default by the same Participant, pursuant to action being taken in terms of Rule 11.5 (ii) (a) above, the CDS shall initiate disciplinary action against such Participant in terms of Section 17 of these Rules.

#### **11.6 Implementation of enforcement action**

Without prejudice to the provisions of the Rules set out herein, the CDS shall be entitled to take any action or step as is necessary to implement and give effect to the enforcement actions referred to in Rules 11.4 and 11.5 above. The CDS shall, immediately upon deciding to take enforcement action in terms of Rules 11.4(A)(a), 11.4(A)(c) and 11.5(ii)(a)(1) above, provide written notification thereof to the CSE.

#### **C. Utilization of the Settlement Guarantee Fund**

In the event of a default of fund settlement by a Participant and the collateral furnished to the CDS is insufficient to satisfy the settlement obligations of such Participant, such Participant may obtain funding from the Settlement Guarantee Fund (SGF) to meet outstanding settlement obligations, subject to the conditions stipulated by the SGF. For the avoidance of doubt, any refusal or rejection by the SGF to provide funding to the Participant pursuant to a request being made therefor by the Participant, for any reason whatsoever, shall not relieve the Participant from its outstanding settlement obligations in any manner whatsoever.