ACSA
Australian Custodial Services Association

Monday 7th April 2014

ASX Limited
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Attention: Diane Lewis

Australian Custodian Services Association – Submission on ASX consultation paper: "Shortening the Settlement Cycle in Australia: Transitioning to T+2 for Cash Equities"

The Australian Custodian Services ('ACSA') is the peak industry body representing members of Australia's custodial and administrator sector. Collectively, the members of ACSA hold securities and investments in excess of AUD$1.8 trillion in value in custody and under administration. Members of ACSA include BNP Paribas, Bank of America, Citi Securities, National Australia Bank Asset Servicing, JP Morgan, HSBC, State Street, RBC Investor Services and Northern Trust.

This submission is intended to provide the Australian Securities Exchange ('ASX') with the views of ACSA members on the issues raised by ASX's Consultation Paper: "Shortening the Settlement Cycle in Australia: Transitioning to T+2 for Cash Equities."

General comments on the consultation

ACSA members generally support the ASX transition towards a T+2 settlement cycle for cash equities.

Responses to the individual questions raised in the ASX Consultation paper:

Consultation Questions	
Q1	Do you agree with the expected benefits from the introduction of a T+2 settlement cycle for cash equities? If so, please outline the key benefits to your organisation.

Whilst this may be applicable for clearing members there appears to be no direct benefit for custodian members.

Q2	What level of reductions in cash market margin and liquid capital requirements do you expect for your organisation from the introduction of a T+2 settlement cycle? Please indicate if you wish this information to remain confidential to ASX and the regulators, RBA and ASIC.

This is not applicable for custodian members.

Q3	Do you expect the costs associated with the implementation of T+2 to be relatively small, moderate or significant for your organisation? Can you provide a cost range for your implementation of T+2?

ACSA members believe the cost of a move to T+2 should be minimal. This is based on the assumption that there are no changes to the current batch settlement process.

Should there be changes to the current batch process the cost of implementation would increase due to the need for development of core systems and platforms.

Q4	Do you consider that the potential net benefits expected from the introduction of a T+2 settlement cycle for cash equities warrants its introduction in the near term? If so, do you consider that: a. an implementation date in Q1 2016 should be targeted? b. an earlier implementation date in 2015 is feasible for all industry participants and should be considered? If so, what implementation timing do you think should be targeted? c. sequencing the transition to a T+2 settlement cycle with other markets is important, noting that EU member states will be required to operate a T+2 settlement cycle from January 2015?

ACSA supports the suggested implementation of Q1 in 2016.

For the ACSA members who are global custodians the time to analyse the success of the European markets moving to T+2 could also have added benefits.

Q5	To what extent do you currently utilise an automated centralised trade matching system? Please indicate which system you use.

ACSA members, who perform middle office trade matching for clients, use a number of platforms to support this activity.

Q6 What percentage of trades are verified manually by your organisation? If you use manual verification processes, what is the main reason for doing so?

Statistics provided by Omgeo indicate that approximately 90% of trades are matched using matching platforms with 10% being matched manually outside of these platforms.

These statistics tend to agree with the reviews performed internally by a number of ACSA members.

Q7 What is the percentage of trades where affirmation is completed on T+0?

Omgeo has used a sample of data from December 2013 that indicates that around 81% of trades are affirmed on T+0. Again this appears to be in line with the review conducted by ACSA members.

Q8 What are the main reasons for failure to achieve SDA?

Custodians are not able to provide comment on this question.

Q9 In what timeframe could your organisation be reasonably expected to achieve an SDA rate of over 90%?

ACSA members believe a SDA rate of 90% is achievable within the time lines of implementation of T+2 which will see a drive in behavioural change.

Q10 What is the expected investment required for your organisation to implement a T+2 settlement cycle? Do you agree the changes required to implement a T+2 settlement cycle are largely configuration and behavioural changes rather than wholesale system changes?

ACSA members believe, assuming a current single batch approach, expected investment to implement would be relatively low. Any change to have multiple batches would lead to increased costs of implementation.

Client education would also be an important part of any implementation cost.

Q11 Please indicate the most significant reason for a delay in the release of settlement instructions to the market?

Stock availability is seen as a key element in the delay of settlement instructions being released to market.

Q12 What are the key reasons for delaying the matching of settlement instructions until late in the afternoon of T+2 or in the morning of T+3?

ACSA members indicate that client cut offs, especially for those clients who perform affirmation themselves or via a third party, along with stock availability are the main reason for matching starting on T+2 in the current settlement cycle. Custodians will generally not send pre-matching requests into CHESS for delivery messages until they have confirmation of sufficient holdings or covered and pre-matched receipts scheduled for settlement in the same batch.

Q13 Are investor location and time zone differences the main driver for delayed settlement instruction matching? Please indicate the main jurisdictions where delays are common.

ACSA members agree that the location of investors is generally not the main driver for delayed settlement matching however a lack of straight-through-processing coupled with an offshore trading client can exacerbate delays.

Q14 Should the ASX require continued publication of settlement instructions so that they cannot be removed after initial publication and potentially delay the opportunity to match settlement instructions?

ACSA does not see any need for this.

Q15 Should the ASX consider enriching message information to facilitate more timely settlement instruction matching?

ACSA believes any change to the enrichment of messages with additional information would lead to a further need for development and investment. The current messaging is adequate and should remain unchanged.

Q16 Do you think that the introduction of a T+2 settlement cycle is feasible with the existing 10.30am settlement batch cut-off? Please state reasons for your view. If you act on behalf of foreign investors, please indicate the percentage of current trading volumes executed by foreign clients in Asian, US and European time zones.

ACSA members believe consideration of a later settlement batch cut off time should be explored. This would provide an extended settlement window to reduce settlement mismatches and failures within the T+2 cycle. A batch cut off of no later than 12:30pm should be explored to see if this would lead to a decrease in potential failed trades.

It should be noted that custodians set an earlier deadline for the receipt of client instructions for pre-matching and settlement. Custodians use this time to ensure sufficient securities and/or cash is held by the client prior to releasing the settlement instruction to CHESS. This client deadline is generally around one hour prior to market cut-off.

Q17	What are the main internal processes and procedural changes that your organisation would need to introduce to ensure T+2 and batch cut-off settlement deadlines are met? If you do not think moving to a T+2 settlement cycle is feasible with the existing 10.30am settlement batch cut-off, do you think delaying settlement batch cut-off to 11.30am or 12.00pm would provide sufficient additional time to assist in facilitating timely settlement? If so, would the benefits exceed the cost of the flow-on impacts (for example, the likely need to change payment provider deeds and delaying the ASX settlement authorisation notification, payment provider authorisation, and registration cut-off times, together with delaying participant back office processing related to post settlement activity)?

ACSA members believe procedural changes would not be significant.

Q18	What are the main internal processes and procedural changes that your organisation would need to introduce to ensure later batch cut-off settlement can be supported, including internal funding arrangements and operational resource availability?

ACSA members agree changes to the current batch cut off would require some procedural and changes mainly around timeliness of preparation for next day settlements.

Treasury processes would need some adjustment to ensure funding is in place at a different settlement of obligation time.

Q19	Would extending the CHESS system start or end of day times assist with achieving timely settlement in a T+2 settlement cycle? For example, would it assist with off-shore processing?

ACSA members cannot see that extending the start or end of day times long term will bring any significant benefit however this could be considered for a shortened period immediately following implementation of T+2 to assist with the ease of the transition.

Q20	What are the key drivers for settlement failure? Is the lack of access to stock borrowing arrangements or availability of stock a significant driver for failed delivery?

ACSA members see stock shortage (or lack of availability), and missing or incorrect client instructions as the main driver behind settlement failures.

Q21	Please indicate whether you believe the continuation of the current regime and the automatic close-out requirement will provide the appropriate incentives for timely settlement in aT+2 environment.

ACSA members believe the current close-out regime should continue.

Q22	Should the current close-out regime be changed to settlement date +1 (T+4) instead of settlement date +2 (T+5) with the introduction of a shortened settlement cycle?

ACSA members support the opinion that the close out regime should follow the change to T+2 with a day's reduction in the current cycle ie so that close-out continues to be instigated on settlement date plus two business days or T+4 business days.

Q23 Do you think further consideration should be given to using CHESS's existing RTGS functionality to manage late settlements? What would your organisation need to do to use CHESS's existing RTGS functionality? What would your payment provider need to do to use CHESS's existing RTGS functionality?

For ACSA members who could currently optimise this functionality a reduced fee rate would make this a more attractive solution for late settlements.

Q24 Do you think further consideration should be given to running an additional settlement batch to manage late settlements? How do you expect an additional settlement batch would impact your organisation, including the potential cost impact

ACSA members strongly support continuation of a single DvP batch. Any addition of a secondary batch would require widespread changes to business processes and ASX Settlement Rules adding additional cost and technical configuration to support an implementation.

Q25 If running an additional settlement batch introduces material additional costs or regulatory considerations for industry stakeholders or the ASX, would this change your response?

Please see response to Q24.

Q26 Do you have other suggestions for addressing late settlements? Are you able to quantify whether late settlements are a significant issue for you? In your view, is the current mechanism – moving securities free-of-payment through CHESS while moving cash separately – sufficient?

ACSA members do not see the current late settlement processes as a significant issue.

Please also refer our response at Q23

Q27 What role do you think that investor education can play in minimising the potential for increased settlement failure following the introduction of a T+2 settlement cycle? Do you think there is merit in ASX working with the industry to undertake investor education in relation to the transition to T+2?

ACSA believe investor and client education is key to the success in a move to T+2. As identified in the paper a change of behaviour including education is key to the success in a transition to T+2.

ACSA members see education to clients as one of the key investments of implementation.

Q28 Are there particular corporate action events for which the adoption of a T+2 ex period creates significant difficulties?

ACSA members do not believe this will prevent any particular difficulties with the only possible exception being on dual listed securities that can be operating on separate settlement cycles.

Q29 Do you think that a T+1 settlement cycle is achievable to facilitate trading in special markets?

ACSA has no comment on this question.

Q30 Do you support the same approach to the timing of trade netting being taken in a T+2 settlement cycle (that is, settlement date minus two business days (T+0) to allow the netted settlement obligation positions to be available to all participants one day prior to settlement)?

ACSA supports this approach.

The implementation of an earlier netting obligation would assist the tightening of the settlement cycle for clearing participants.

Q31 Will there be significant impacts for your organisation if trade netting was to occur on T+0 if a T+2 settlement cycle is introduced?

ACSA members who are clearing participants don't see this as a significant issue although this is based on the assumption that the ASX will supply a netting obligation earlier that the current process.

Q32 Do you expect a significant impact to securities lending activity due to the introduction of a shortened settlement cycle? If so, please outline the expected impact?

ACSA member believe this is very much determined by client type and types of trading activity. In general if the move to T+2 is strongly supported the impacts of securities lending should not be significantly different than T+3 under the current regime although the time for international investors to cover trades will be shortened. Therefore there may be some increase in securities lending demand during the initial period following implementation.

Q33 Are there any significant additional client or business risks that have not been identified in this paper?

ACSA provides the following points for consideration:

- ACSA members believe that the settlement cycle of Austraclear activity should be considered due to the impact of clients' funding activities. The paper should provide information on if the current Austraclear settlement cycle will change in line with the cash equities markets.

- The products such as ADR's, CDI's, Dual Listed securities and AGB's are also not highlighted in the paper as to whether they will follow the proposed cash equity T+2 cycle. These specific products, along with any other CHESS eligible securities outside of cash equities, should be addressed and information provided to participants accordingly.

- The ASX could consider waiving or reducing the fees associated with failed settlements for a suitable initial period to assist participants manage cost effectively whilst continuing to educate clients after the implementation of T+2.

- ACSA encourages the ASX to continue discussions with the NZX and NZClear to sell the benefits of T+2 to the New Zealand market. Should the New Zealand market not move to the same settlement cycle ACSA envisage issues with dual listed securities that make up a significant trading portion of the New Zealand market.

Yours faithfully

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