



# Enhancing Australia's Equity Settlement System

The Way Forward

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Market Information Document

4 September 2009

## A. Executive Summary

Delays to the CHESSE settlement batch last year highlighted the potential impact that such events could have upon the Australian equity market and in particular on all ASTC Settlement Participants. The single batch settlement approach of CHESSE is very efficient but, should a Settlement Participant fail to meet a payment deadline, additional complexities may arise. The Reserve Bank of Australia (RBA) subsequently published a review of market events and, in consultation with ASX, provided some suggestions for further analysis aimed at improving the current system, many of which have already been implemented.

Earlier this year, ASX received stakeholder feedback on its Consultation Paper, *Enhancing Australia's Equity Settlement System* and a summary of the responses was subsequently published. The Consultation Paper sought feedback on a number of proposed modifications and potential changes to the current operation of the equity settlement system. The proposals and suggestions put forward were aimed at supporting the initiatives already taken by ASX to further enhance the management of settlement risk and ensure market certainty of ASX actions in response to CHESSE settlement delays.

ASX is committed to delivering the secure and efficient equity settlement services that are essential to the operation of the Australian equity market. As such, the ASTC and ACH Boards have carefully considered the alternative arrangements utilising the feedback. These have been assessed under four broad criteria:

1. Regulatory compliance with ASTC's and ACH's obligations as Clearing and Settlement Facility Licensees;
2. Settlement and counterparty risk management improvements;
3. Market enhancement; and,
4. Operational and implementation effort and cost, relative to the benefits.

Over the past 18 months, ASX has undertaken several major initiatives that have demonstrably improved the settlement performance of CHESSE and put in place enhanced processes to respond to any future CHESSE batch settlement failure. In general, the broad approach outlined in this document continues the proportionate response initiated last year to address the potential settlement complexities. ASX regards CHESSE as a proven, successful settlement system that has served the marketplace well. Settlement failures have been very infrequent and future changes will take into account the strengths of the current system, in particular the proven efficiency of CHESSE.

As a result, ASX will be undertaking additional improvements to the CHESSE settlement system, including;

- New internal deadlines at times of CHESSE batch settlement failure;
- Reduced Payment Provider response times;
- Removal of ACH derivatives margin payments from the CHESSE batch;
- Amended LEPO expiry settlement processes; and
- Higher standards for Payment Providers.

ASX also considered some further key structural changes to the CHESSE settlement mechanism. Although the proposals have merit, the overall market risk/reward outcomes in the current environment are not sufficiently persuasive and accordingly, at this time these initiatives will not be pursued further.

- Removal of equity cash market transaction types from the CHESSE batch;
- Mandatory CHESSE RTGS connectivity; and
- Separation of the equity cash market clearing account into house and omnibus client accounts.

ASX will continue to monitor closely the performance of the CHESSE batch and re-visit these proposals where appropriate. CHESSE RTGS connectivity is seen as an important longer-term aim and ASX will continue to encourage its adoption by all Settlement Participants.

## B. Introduction

Delays to the CHESSE settlement batch last year highlighted the potential impact that such events could have upon the Australian equity market and in particular on all ASTC Settlement Participants. CHESSE's single batch settlement approach is very efficient but, should a Settlement Participant fail to meet a payment deadline, additional complexities may arise.

The Reserve Bank of Australia (RBA) subsequently published a review of market events and, in consultation with ASX, provided some suggestions for further analysis aimed at improving the current system, many of which have already been implemented. Following preliminary discussions with ASX and a representative sample of market users, RBA and ASX undertook a series of discussions around these and other alternatives.

As part of this initiative, ASX released a Consultation Paper, *Enhancing Australia's Equity Settlement System*. The paper sought feedback on a number of proposed modifications and potential changes to the current operation of the equity settlement system. A summary of the responses was subsequently published.

The proposals and suggestions put forward in the consultation paper were aimed at supporting the initiatives already taken by ASX to further enhance settlement risk management and ensure market certainty of ASX actions in such market events. In particular, they sought to tackle the following key issues:

- Potential for all equity settlements to be delayed due to the inability of a single Settlement Participant to complete settlement on a timely basis;
- Ability for voluntarily failed settlements to cause another Settlement Participant to default;
- Concentration of settlement activity immediately prior to the CHESSE batch cut-off deadline;
- Transparency issues with securities lending transactions;
- Possibility that a failure to pay a non-novated settlement may cause a Clearing Participant default; and
- A lack of market familiarity with the processes that ASTC undertakes to resolve a Settlement Participant's failure to pay.

The main<sup>1</sup> potential changes implemented to date or put forward for discussion were designed to either:

(i) Minimise the possibility of the CHESSE batch payment failure or delay occurring by:

- Increasing disincentives to failing to deliver stock as scheduled;
- Provision of information to enable Settlement Participants and ASTC to better identify potential future problems e.g. greater transparency over stock lending and short selling; and
- Separation of larger, often unrelated, transactions from the batch; or

(ii) Reduce the impact in the event of a CHESSE batch settlement failure and consequent delay through:

- The ability for other settlements to continue;
- Alternative arrangements to more quickly settle key transactions post-settlement failure;
- Maximisation of timetable clarity and communications during a settlement incident;
- Clarity and understanding of the arrangements in such circumstances; and
- Minimising contagion with other markets.

The ASTC/ACH Boards have given careful consideration to the alternative proposals utilising the feedback received from stakeholders to the consultation document. The proposals have been assessed under four broad criteria:

### 1. Regulatory Compliance

ASTC and ACH are required to comply with obligations relating to their respective Clearing and Settlement Facility Licences (CSFLs). Such obligations include providing services that are fair and effective and

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<sup>1</sup> Note that the origins of the proposed change to the account structure outlined differ from these objectives. In this instance the change for discussion is primarily designed to assist ACH in the event of a Clearing Participant default.

reasonably practical to reduce systemic risk; compliance is overseen and annually reviewed and assessed by the Australian Securities and Investment Commission (ASIC). In addition, both CSFLs must meet stability and risk requirements, including compliance with the Financial Stability Standards (FSS), overseen and annually assessed by the Reserve Bank of Australia (RBA).

## 2. Risk Management

ASTC and ACH are responsible for managing and mitigating the risk associated with the provision of settlement and CCP clearing services respectively, in line with the risk appetite of the ASX Group. Such risk management functions include the mitigation of systemic risk, in particular through the prudent management of ASTC's settlement risk and ACH's counterparty risk. In addition to the ASX's own risk appetite, the FSS also imposes standards for the management of risk, which are subject to an annual compliance assessment by the RBA.

## 3. Market Enhancement

As a service provider, ASTC and/or ACH may initiate changes to meet demonstrable market demand where appropriate. This may include an expansion of services to other markets or participants, or modification of the existing service to better meet the needs of users or enhance market efficiency and effectiveness.

## 4. Operational Effort

The ASX Group has considered the likely effort required from stakeholders in implementing the various proposals. For the initiatives that reduce risk or are regulatory-driven, such operational concerns are of secondary consideration. This is consistent with recognition that the benefits, rights and advantages afforded by Settlement and/or Clearing Participant status are necessarily accompanied by certain obligations and related cost/resource impacts. In contrast, for initiatives that support market enhancement or market demand, the operational impact of both implementation and maintenance may be of greater importance in determining their progress.

Each initiative has been assessed in broad terms against these criteria; a summary of the analysis and outcomes is outlined below. Enquiries should be directed to Paul Jones (paul.jones@asx.com.au) or Tim Hogben (tim.hogben@asx.com.au).

## Rationale for the Chosen Enhancements

ASX is committed to delivering secure and efficient equity settlement services that are essential to the operation of the Australian equity market. As such, the ASTC and ACH Boards have carefully considered the alternative arrangements designed to enhance these services through improved settlement risk management.

CHESS is a proven, successful settlement system that has served the marketplace well. But as with any Model 3 settlement system, there is scope for a settlement failure to have a significant impact on the wider Australian marketplace given the close inter-dependency of all netted transactions in the batch. However, it is important to note that such events have been very infrequent and that any changes must take into account the strengths of the current system and in particular the proven efficiency of CHESS. Moreover, all significant changes present new challenges and risks in both implementation and execution.

Over the past 18 months, ASX has undertaken several major initiatives that have demonstrably improved the settlement performance of CHESS and put in place enhanced processes to cater for any future CHESS batch settlement failure. In general, the broad approach outlined in this document continues the proportionate response, initiated last year, to the potential settlement complexities. It further extends the range of measures already undertaken and provides for continued monitoring of the CHESS batch settlement composition to escalate any emerging potential issues.

The following sections outline the proposed changes and those on which ASX intends to take no further action in the short-term, accompanied by the rationale for those decisions.

## C. Changes Implemented or in Progress

ASX has recently made a series of changes enhancing the equity settlement processes to promote further settlement efficiency and improve the management of settlement risk. Indicators such as an initial settlement fail rate being as low as 0.09% in July 2009 demonstrate that these changes have had a positive impact on efficiency and certainty in the equity settlement process. The changes are summarised below.

### Implemented

#### (i) Settlement Shortfall Fees

On 1 September 2008, ASTC implemented increases to settlement delay fees for securities shortfalls. Whilst the daily trade value fee remained at 0.1% of the settlement shortfall, the minimum fee increased from \$50 to \$100 and the maximum fee from \$2,000 to \$5,000 per security per day. The changes to the fee floor and cap act as a greater disincentive for settlement fails by encouraging Settlement Participants and their clients to have access to securities before conducting a share sale. ASTC continues to monitor the impact of the new fail regime in reducing the number and value of settlement delays with a view to considering further changes if required. Currently, settlement failure rates are below 1% which, as the RBA has noted, is amongst the lowest failure rates in the world. Fail rates<sup>2</sup> are broadly declining: in July 2009 the source fail rate (i.e. the initial point of settlement failure) stood at 0.09% in comparison with 0.34% in June 2008, which subsequently resulted in a knock-on impact rate in July 2009 of 0.39% in comparison with 1.81% in June 2008.

#### (ii) CHES Processing Schedule Changes – Pre-Settlement Activity

From 1 December 2008, CHES start of day applications commenced two hours earlier. Start of day commencement of CHES Online Processing moved from 8am<sup>3</sup> to 6am with the commencement time for the application processing of some Security Registrar messages changing from 7.10am to 5.10am. Further details are available in ASTC Bulletin No 358 of 22 October 2008. Both changes widen the window for pre-batch submission of settlement instructions and therefore provide greater potential and timeframe to highlight and manage settlement issues for both Settlement Participants and ASTC.

#### (iii) Automatic 'Close-Out' Requirement

ASTC introduced a settlement close-out obligation on 30 March 2009. The obligation applies to those Settlement Participants that enter the Batch Settlement process with a net short position where a resulting settlement shortfall remains after the completion of settlement two (2) business days later (i.e. generally T+5). The close-out requirement complements current economic disincentives by providing a means to guarantee that settlement delays have an end date. The introduction of a close-out obligation has further improved settlement certainty and efficiency by acting to accelerate the clearing of settlement delays. In May 2009, 85% of those settlements that were not completed on T+3 (i.e. 0.53% of all settlements) settled on T+4 and 95% were settled by T+5, compared to an average of 80% and 91% respectively in the March Quarter of 2009.

#### (iv) Increased Transparency of Settlement Performance

ASTC has been active in increasing the transparency of settlement performance benchmarking (e.g. fail rates and fees) within Settlement Participants. Monthly statistics are sent to both Operations and Compliance representatives of each Settlement Participant and peer group reporting has been introduced to enable Settlement Participants to benchmark themselves against peers.

<sup>2</sup> Number of scheduled settlement instructions that failed to deliver as a percentage of the scheduled settlement instructions.

<sup>3</sup> All times quoted are Sydney time.

**(v) CHESSTRTGS Service**

In response to Settlement Participant concerns regarding the bi-lateral counterparty risk of transactions outside the daily settlement batch, ASTC has begun to heighten awareness of the availability and benefits of its RTGS service. The CHESSTRTGS service allows Participants the option of DvP settlement of equity transactions on a line-by-line basis within CHESST, instead of having to settle non-DvP with payments made outside of CHESST, or be constrained by the timing requirements of once-daily net batch settlement processing.

## In Progress

**(i) Increased Transparency of Transactions**

Implementation of CHESST Release 7.0 is scheduled for later this year. The key driver for the release is the variation to the Reserve Bank of Australia's Financial Stability Standards for Securities Settlement Facilities requiring greater disclosure of settlement information by ASX. Improving the transparency of securities lending in the Australian equity market is included within this. Framing this key driver are further settlement risk enhancements, inclusive of a new automated CHESST message to support the "close-out" requirement and a CHESST message to notify of changes to scheduled settlement cut-off times. Both these initiatives will provide more timely communication of important settlement-related events.

From 25 May 2009, ASTC also provided the technical capability for the daily reporting to ASX of outstanding on-loan and borrowed positions by security. Reporting is currently provided on a voluntary basis (i.e. pilot phase). Subject to regulatory approval, mandatory daily reporting of outstanding on-loan and borrowed positions will commence by the end of December 2009.

**(ii) Understanding of the Clearing & Settlement Process**

ASTC is committed to facilitating a greater understanding of clearing and settlement within the market. A clearing and settlement education and communication strategy is being implemented to enhance levels of understanding in the market as to clearing and settlement arrangements. Areas to be covered will include principles such as novation, the role of central counterparty, types of settlements, corporate actions, settlement timeframes and more complex activities such as default management processes. The first aspect of this strategy is near completion - to improve clarity for Payment Providers as to their role and obligations in the daily settlement cycle.

**(iii) Website Information**

ASX is currently in the process of increasing and consolidating the Clearing and Settlement information on its website. The move will enable market users to access relevant information more easily and seeks to complement the education strategy referenced above by enhancing the general levels of understanding with regard to the details of ASTC settlement processes.

**(iv) Market Communications**

ASX has existing communications protocols with Clearing and Settlement Participants and system vendors which have served the market well. These arrangements are system-based and properly integrated within the Participants' day-to-day operational environment where clearing and settlement or CHESST information is effectively provided, whether it relates to daily system updates or wider industry developments. However, ASX has recognised the need to refine these arrangements and position them in the context of a broader communications strategy, consistent with other ASX market functions, where any scenario or market-wide issue (such as experienced in January 2008) can be accommodated. This will encompass the broader stakeholder community and address the need for accurate, timely and transparent communications on relevant issues or market incidents.

## D. Key Structural Changes

In its consultation document, ASX highlighted the potential to introduce several significant structural changes to the CHESB settlement methodology. Conclusions from further analysis conducted by ASX are outlined below.

### (i) Moving of Equity Cash Market Transactions from the CHESB Settlement Batch

In exploring an alternative Model 1 settlement system, ASX has sought to identify the key benefits of this approach and seek means whereby aspects of the model may be applied to the existing CHESB capabilities to reduce settlement risks. The principal benefit of a Model 1 approach is that the separation of settlements on a line-by-line basis significantly reduces the prospect that an inability to settle one transaction defers settlement of unrelated transactions or between unrelated Settlement Participants. ASX considered several alternatives to the current CHESB batch arrangement, namely;

- All Transactions except IPOs to settle in the Batch;
- Removal of all Primary Market Transactions from the Batch; or
- Removal of all Transactions other than those originating from the central limit order book and related non-novated settlements.

ASX recognises that this improvement in systemic settlement risk management is achieved by reducing netting and therefore lowering the settlement efficiency of the system. As highlighted by recipients to the consultation document, the use of RTGS as an alternative for any transaction types removed from the CHESB batch creates additional operational and settlements risks, mainly associated with a loss of straight-through-processing.

Having given the alternatives careful consideration, ASX does not believe that the magnitude of the settlement risk reduction warrants the potentially significant reduction in settlement efficiency. As a result, ASX does not intend to make any changes to the composition of equity cash market transaction types utilising the CHESB batch. However, ASX does acknowledge that individual transactions with high value and a low degree of inter-relationship with other CHESB batch transactions, e.g. IPOs, have a greater theoretical potential to disturb the CHESB batch. Consequently, ASX will continue to monitor the impact of such transactions and again review the CHESB batch composition if required.

### (ii) Mandatory CHESB RTGS Connectivity

Given ASX's decision not to remove any equity cash market transaction types from the CHESB batch, the potential requirement for mandatory connectivity to the CHESB RTGS functionality is limited to it acting as an alternative means of re-scheduling transactions after a CHESB batch settlement failure. In addition, the service continues to provide an alternative, but currently unused, DvP settlement mechanism for bilateral transactions currently settled non-DVP with payment outside of CHESB.

ASX believes that connectivity with CHESB RTGS for all Clearing Participants would be beneficial for the marketplace as a whole and would provide a secure and important means for settling equity transactions following a CHESB batch payment failure. However, ASX recognises that reliance on this mechanism cannot be complete unless it is regularly used by all Settlement Participants. As there is currently no requirement for any equity transaction types to settle routinely using CHESB RTGS, ASX will not be making connectivity to CHESB RTGS mandatory at this time. Nevertheless, ASX will actively encourage Settlement Participants to establish connections to CHESB RTGS and sees comprehensive Settlement Participant connectivity with CHESB RTGS as an important longer-term goal. In the future, ASX will review the level of voluntary CHESB RTGS use and, if required, reconsider the need for mandatory connectivity, especially for the largest Settlement Participants that have the potential to cause the greatest disturbance in the CHESB batch.

### (iii) Changes to Arrangements Prior to CHES Batch Cut-Off

In some circumstances, failure to match significant non-novated transactions may result in unexpected changes to a Settlement Participant's requested CHES batch net funding obligation. Where this results in a significant increase in the required payment relative to expectations, this may cause settlement issues. ASX has investigated changes that could be made to reduce the probability of such an event and to facilitate immediate amendments to settlement instructions to alleviate any difficulties before CHES payment provider approval is sought. In particular, ASX put forward two alternatives for consideration:

- Later CHES settlement batch cut-off times to provide further opportunity to match transactions
- Establishment of a 'pre-finalisation' period to allow Settlement Participants on an emergency basis to correct unmatched settlement instructions that have created a potential payment difficulty.

ASX agrees with the feedback that the potential use for such initiatives is limited and is likely to be accompanied by a detrimental behavioural change that is more likely to defer than solve any issues. Moreover, ASX has already taken steps to increase the length of the CHES transaction processing period ahead of the daily settlement batch cut off by bringing forward CHES opening hours by two hours. As a result, ASX does not intend to progress these alternatives at this time.

### (iv) Equity Cash Market Clearing Account Structures

ASX is of the view that the proposal to separate house and client accounts would assist position and account management following the default of a Clearing Participant and in some circumstances could strengthen existing client segregation arrangements. However, such separation does not unambiguously improve risk measurement or mitigation. Indeed, several respondents argued that the gross funding of two separate obligations increases operational risk and may also increase settlement risk in some circumstances; a position that ASX acknowledges. The consultation process also raised the issue of the potentially significant market impact, as the proposal requires market-wide implementation of separated Cash Market accounts. This is despite only a small number of Clearing Participants with proprietary trading, signifying that the implementation and maintenance requirements may be disproportionate to the benefits received given the current market structure.

While ASX supports the potential additional protection that would be afforded to underlying clients resulting from the separation of settlement of house and client transactions in the ACH equity cash market, ASX concluded that on balance the benefits in a default of such account separation do not, at this stage, outweigh the potentially significant costs of such a change. In reaching this conclusion, ASX also recognised the importance of,

- the client segregation protections already in place in the HIN stock holding rules and cash trust account arrangements, that are demonstrably more powerful than the proposed separation of house and client accounts; and,
- the client compensation arrangements provided by the SEGC's National Guarantee Fund.

Nevertheless, in light of the potential benefits that account separation could produce, client/house segregation remains a longer term objective for ACH. ASX will revisit the proposal in the future should any significant systems development or changes to market structure present the opportunity for its introduction. Any future introduction of margining (or similar) to the equity cash market would undoubtedly require this topic to be re-visited: it will be included in the forthcoming consultation document on CCP risk controls later this year.

## E. Future Modifications

This section outlines further improvements to the daily CHESSE settlement batch arrangements that ASX will be introducing in the near future. More implementation details will be provided in due course.

### (i) CHESSE Settlement Batch Timings

Under the CHESSE Payment Provider Deed, CHESSE settlement batch payment requests must be responded to within 90 minutes of receipt, although typically payments are confirmed by 11.20a.m. Currently, where a CHESSE Payment Provider has not confirmed a CHESSE batch payment request by the prescribed time or has indicated an intention not to confirm such a payment, ASX operational protocols result in ASX seeking to ascertain the cause before subsequently taking action. This period may delay settlement not only for the Participant concerned but for the whole market.

To reduce the potential for a protracted settlement impacting the whole market, ASX will be undertaking three revisions to the daily CHESSE batch operational timetable and procedures:

- a) The introduction of an internal deadline of 1 hour after all payment requests should have been confirmed, at which point ASX would enact its 'backout' algorithm for any unconfirmed payment request. ASX will need to retain some flexibility to cater for exceptional circumstances.
- b) Ensure that Payment Providers have the capability to individually approve each Settlement Participant's payment request, rather than waiting for all payments to be internally confirmed before sending all approvals together.
- c) In the longer term, ASX will seek to reduce the 90-minute Payment Provider response time to 1 hour.

Under the proposed arrangement, where a Payment Provider has not confirmed a Settlement Participant's requested payment by this deadline, ASX would automatically and immediately run the 'back-out' algorithm to reschedule some of its settlements to the next day (or potentially later the same day if possible).

These changes should benefit the market by providing more certainty over the settlement timescales and thereby avoid the uncertainty that could arise from a protracted settlement delay. However, ASX recognises that such a change would reduce its flexibility and would need the introduction of additional steps: a new mechanism for Settlement Participants to formally request a delay to settlement would be required to handle instances where systems or operational problems have unavoidably prevented a Payment Provider from communicating its payment confirmation. In addition, the change could create more batch payment failures and the circumstances would require very thorough investigation before any subsequent ACH Clearing Participant default was declared.

### (ii) Removal of ACH Derivatives Margin Payments from the CHESSE Batch

Daily ACH derivatives margin payments are currently made in either the CHESSE batch or via an Austraclear payment in Exigo. ACH Clearing Participants will be aware that ACH recently mandated the use of Exigo for the settlement of intra-day margin calls. ASX intends to remove the option to settle daily margin payments from the CHESSE batch and require settlement of the client and house payments separately in Exigo by 10a.m. each morning.

The proposed change will reduce systemic risk in three ways:

- The central counterparty will receive earlier confirmation of margin receipt or any potential event of default. Under current arrangements, ACH may not receive such confirmation until after midday.
- Removal of netting between derivatives margins and other CHESSE batch transactions reduces the possibility of contagion from a failure to pay in either market being transmitted to the other.
- The removal of payment netting across ACH house and client accounts will improve account segregation and therefore enhance client protection. The change would bring ACH into line with international industry best practice.

In its 2008 Annual Assessment of ACH under the Financial Stability Standard<sup>4</sup>, the RBA noted this issue as a topic for further consideration. The report noted "*a strong case to consider whether the robustness of the system would be improved by settling margin payments via Austraclear or an alternative real-time gross settlement channel.*"

### **(iii) Amendments to the LEPO Expiry Settlement Process**

ASX is aware that the removal of the ACH derivatives margin payments from the CHES batch could increase settlement risks in respect of cash market transactions arising from the monthly LEPO expiry. Currently the payment of derivatives margins in the CHES batch assists in providing DvP settlement for LEPO exercise settlements. Where a Settlement Participant pays margins outside of the CHES batch, the settlement is no longer DvP and principal risk exists during the time between the settlement of the margin and the associated stock movement. This risk already exists for those Clearing/Settlement Participants utilising Exigo to settle ACH margins but, for the market as a whole, will be further increased by the mandatory removal of ACH derivatives margin payments from the CHES batch.

In order to mitigate against this risk, and after discussions with the RBA, ASX will be amending LEPO settlement arrangements. This will be undertaken in two stages. In the short term, ACH will adjust its margin payment processes, for Clearing Participants with net short LEPO positions scheduled for delivery, to defer ACH margin payments until the stock has been received. In practice, this will make little difference as the CHES batch often completes before margin payments to Clearing Participants are processed in RITS.

Whilst this short term solution will protect ACH against principal risk, it is not a fully robust DvP solution for LEPO expiries. Consequently, it is intended that further changes will be made to enhance the settlement mechanism. Under these longer-term plans, LEPO expiries will be settled in the CHES T+3 cycle at the underlying stock price at the time of LEPO expiry rather than the \$0.01 per share strike price of the option. Current arrangements for the payment of LEPO premium (the 'balancing payment') and margining of LEPO positions during the settlement period will also be amended.

### **(iv) Mandatory Settlement of Transactions post Settlement Default**

The Consultation Paper sought comments on amendments to the Settlement Rulebook to provide ASTC/ACH with the power to require transactions to be settled intraday using CHES RTGS following a settlement default. In practice, ASTC would identify transactions that it believed threatened the successful completion of the CHES batch and seek immediate bilateral RTGS settlement of those transactions. By isolating those transactions, ASTC would be reducing the potential contagion with all other settlements, therefore reducing the potential for further settlement delays and potential systemic risk.

ASX recognises that there is the potential for re-scheduled transactions to create similar problems for the CHES batch on the settlement day after a default. However, without mandatory connectivity to CHES RTGS, no clear alternative mechanism with complete Settlement Participant coverage exists. Nevertheless, ASTC and ACH will continue to examine their Rulebooks with the intention of introducing greater flexibility and where necessary greater powers to require transactions to be removed from the CHES batch, where it is believed that such settlements threaten the successful completion of the batch.

### **(v) Pre-Committed Payment Provider Approval Limits**

Currently, all payment requests must be approved by a CHES Payment Provider after the request for payment has been calculated shortly after 10.30a.m. each day. ASX sought comment on a new facility whereby the Payment Providers would pre-specify an amount for each Settlement Participant up to which the payment would automatically be approved without the need for further confirmation. The proposal sought to prevent unnecessary operational delays to the CHES batch caused by slow responses to requests for payment confirmation of relatively small amounts. Furthermore, the transparency of pre-approval amounts to ASTC could potentially assist its pro-active management of the CHES batch settlement process.

<sup>4</sup> See "*2007/08 Assessment of Clearing and Settlement Facilities in Australia*" (October 2008) at [http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/2007\\_08\\_report\\_clrg\\_settlement\\_facilities.pdf](http://www.rba.gov.au/PaymentsSystem/StdClearingSettlement/Pdf/2007_08_report_clrg_settlement_facilities.pdf).

ASX sees merit in such an arrangement but believes that an alternative approach would be more practical and cost effective for the market. Rather than implementing a market-wide solution to minimise the possibility of the problems occurring, ASX will work closely with Payment Providers to increase understanding and improve their operational reliability. In so doing, ASX may seek to formally raise minimum standards for Payment Providers and seek powers to impose greater financial penalties for persistent transgressors. Should these new standards not reduce the frequency of late payments, ASX will re-visit the need for pre-committed Payment Provider approval limits.

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