



## **MEDIA RELEASE**

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### **Management of Settlement Risk - New Measures Announced**

The Australian Securities Exchange (ASX) welcomes the conclusion in the Reserve Bank of Australia's (RBA) *Review of Settlement Practices for Australian Equities*, released today, that current settlement practices have served the Australian equity market well over a number of years.

Mr Colin Scully, ASX's Group Executive, Operations said: "ASX Settlement and Transfer Corporation has processed rapidly rising levels of Australian equity trading activity in recent years in a manner that has contributed to the efficient operation of the overall market."

"While the events of 29 and 30 January 2008 presented challenges to the settlement arrangements on those days, ASX believes the existing systems worked effectively and as they were designed to do", said Mr Scully.

The RBA's *Review of Settlement Practices for Australian Equities* also raises the issue of minimising settlement delays. ASX released a consultation paper on 28 March on short selling and the management of settlement risk that included discussion on the same issue.

On the minimising of settlement delays, ASX has today released a market circular detailing measures it will introduce to promote further settlement efficiency and improve the management of settlement risk. These measures include the introduction of a close-out requirement, an increase in settlement delay fees, and accelerated processes for referring lengthy settlement delays to the ASX Disciplinary Tribunal. More information on these measures is contained in the attached market circular.

Mr Scully said: "ASX will continue to examine ways to improve our processes. The independent RBA review is an important step along this path, and we will work with the RBA and market participants to explore options that strengthen the value of a robust and well-tested settlement infrastructure."

On the issues around the reporting of short selling, ASX is continuing to consider the submissions and the nature of possible changes to ASX rules resulting from the legislative changes foreshadowed by the Government.

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## ASX Circular

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### Key topics

1. Management of Settlement Risk;
2. Settlement Delay Fee Regime;
3. New Automatic Close-out Requirement.

### Reading List

Client Advisers  
 Compliance Managers  
 ASTC Participants  
 ACH Participants  
 Operations Managers (back office)  
 Share Registries Banks  
 Corporate Advisory  
 Managing Directors  
 Office Managers  
 Market Participants

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## MANAGEMENT OF SETTLEMENT RISK

On 28 March 2008 the Australian Securities Exchange (ASX) released a public discussion paper on a range of possible initiatives that could improve the transparency of the volume of short selling and ASX's management of settlement risk.

ASX received a large number of submissions from stakeholders which expressed a diverse range of views. This Circular sets out changes that ASX will make to ASX's management of settlement risk.

The Reserve Bank of Australia (RBA) examined the settlement fail regime as part of its broader "Review of Settlement Practices for Australian Equities." This Circular also addresses some of the issues raised in the RBA review.

As the ASX discussion paper highlighted, Australia's current settlement performance is very good. Around 1% of all trades are delayed beyond the normal T+3 settlement deadline, and most of the shortfall is settled by T+5 at the latest. Settlement shortfalls can arise for a number of reasons, both operational and logistical.

There is no evidence that short selling (either 'covered' or 'naked') is a significant contributing factor to settlement delays.

### Settlement Delay Fee Regime

ASX Settlement and Transfer Corporation (ASTC) levies a daily settlement delay fee against Participants for settlement shortfalls. The current fee is 0.1% of the trade value outstanding, with a minimum (floor) fee of \$50 and a maximum (cap) fee of \$2,000 per security, per day. These thresholds equate to settlement shortfalls of \$50,000 and \$2 million respectively.

The minimum and maximum fees have remained unchanged for a number of years and have not kept pace with the increase in daily traded volume and value over time. The RBA supported ASX's review of the settlement delay fee regime and noted that there may be a case for increasing the floor and cap fees, as well the general ad valorem rate applied to the value of any shortfall.

Analysis of settlement shortfall data indicates that an adjustment to both the floor and cap is appropriate:

- around 65% by number and 3% by value of all settlement shortfalls are for amounts less than \$50,000;
- around 2% by number and 60% by value of all settlement shortfalls are for amounts greater than \$2 million.

After considering a range of options, it has been decided that ASTC will maintain the daily trade value fee at 0.1% of the settlement shortfall but will increase the minimum fee to \$100 and the maximum fee to \$5,000.

The evidence suggests that the current minimum \$50 fee does not act as an adequate disincentive for the large number of small fails and is often absorbed by Participants rather than passed on to clients. Doubling the minimum fee is intended to provide the incentive for Participants to ensure their clients have access to securities before conducting a share sale.

Similarly, while the existing settlement delay fee generally exceeds the daily cost of borrowing the stock to arrange for timely settlement, the absolute value of the fee is not necessarily sufficient for the Participant to pass on the cost to the end client. The increase in the cap to \$5,000 a day is designed to ensure that Participants and their clients have a greater economic disincentive to fail to meet their T+3 settlement requirements. Analysis of settlement delays over a 12 month period indicates that of those delays above the existing \$2 million cap threshold, the majority fall into the \$2 - \$5 million range.

To provide Participants with time to review their existing processes, implement any necessary changes and inform their clients of the new regime, ASX will introduce the new settlement delay fee structure from 1 September, 2008.

ASTC will closely monitor the impact of the new fee regime on reducing the number and value of settlement delays over the first six months of operations with a view to considering further changes if required.

#### **Automatic 'Close-out' Requirement**

In the discussion paper, ASX sought views from the market on the introduction of a buy-in mechanism, as currently applies in some other countries. Under such a mechanism, the exchange or clearing house would purchase shares in the market to close-out any settlement shortfall, with the ultimate cost being borne by the failing Participant. Feedback on the proposal was split, with some seeing possible benefit in such an arrangement but with a comparable number asserting that it would offer little value.

The RBA's settlement review also indicated that it believed other measures, such as buy-in or close-out arrangements would be worthy of further exploration.

A few submissions argued that there may be greater merit in ASX amending its Settlement Rules to enforce a close-out requirement on Settlement Participants rather than establishing a buy-in arrangement. Under this mechanism, after a specified date, a Settlement Participant would be required to close-out a client's delivery shortfall by purchasing or borrowing the shares to complete settlement. Settlement of the outstanding position would be completed no later than three days after the date of the automatic close-out (to allow for settlement of the close-out transaction).

ASX believes such a close-out requirement would complement the increased economic disincentives imposed through the new delay fee regime, by providing a means to guarantee that settlement delays have an end date. ASX understands that some Participants already have such close-out arrangements in place with their clients.

Accordingly, ASX will be moving to amend its Settlement Rules to require Settlement Participants to close-out any settlement shortfalls that remain after the close of business on T+5. This period was chosen based on advice from Settlement Participants who have significant dealings with overseas clients/custodians and are at times exposed to unavoidable delays, and to be consistent with the application of books close and diary adjustment processing for corporate actions (i.e. 5 day 'ex period').

To allow time for ASX to amend the Rules and for Participants to incorporate the close-out requirement into their systems, it is proposed that the new Rules would not take effect before 1 January, 2009, subject to regulatory approvals.

**Referral for Possible Disciplinary Action**

ASX already has processes in place to refer serious settlement delays to ASX's Disciplinary Tribunal. The Tribunal has the power to fine a Participant for settlement delays.

For recent examples see: [http://www.asx.com.au/supervision/enforcing\\_rules/disciplinary\\_matters.htm](http://www.asx.com.au/supervision/enforcing_rules/disciplinary_matters.htm).

ASX will enforce the new close-out requirement by referring any outstanding settlement position that has not been resolved by T+10 to ASX Market Supervision for investigation and possible referral to the Disciplinary Tribunal.

The suite of policy responses contained in this Circular (increased settlement delay fees, close-out arrangements, and enhanced disciplinary processes) are designed to work together to encourage further improvements in the equities settlement arrangements. As the RBA noted in its review of equities settlement, timely settlement is important "not only from a stability perspective, but also from a market efficiency perspective." As noted above, ASTC will closely monitor the impact these new measures have on settlement performance and will consider further measures if necessary.