



Shortening the Settlement Cycle in Australia: Transitioning to T+2 for Cash Equities

**Consultation Paper
25 February 2014**

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Introduction

The Stockbrokers Association of Australia would like to make the following comments in relation to ASX's consultation on cutting the settlement period for equities to T+2, discussed in the ASX Consultation Paper *Shortening the Settlement Cycle in Australia: Transitioning to T+2 for Cash Equities* dated 25 February 2014 (the **Consultation Paper**).

As noted in the Consultation Paper, the move from T+3 settlement to T+2 was considered in a White Paper released by GBST Capital Markets in association with the Stockbrokers Association of Australia in January 2014 *Introducing T+2 for the Australian Equities Market* (the **GBST Paper**).

We note that the *ASX Forum* established under its *Code of Practice* in 2013 – on which the Association is represented - has given a high priority to the introduction of T+2 settlement and has it has a standing item on its agenda.

The Consultation Paper notes the international moves to T+2 and the benefits of the change in terms of cost, capital and risk reduction. The new regime is planned to apply from Q1 2016.

Comments on Consultation Paper Questions

We would now like to address some of the questions set out in the Consultation Paper. We will not be commenting on questions relating to the specific circumstances of particular participants, which we leave for their own submissions. We will concentrate on making comments of broader relevance that Members have made during our discussions.

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.*

a. Cost Reduction

One of the key benefits is potential cost reduction. This has several elements:

Daily Cash Margin

The GBST Paper finds possible reductions of up to 30% in cash margin requirements. ASX has estimated that based on analysis of trading in 2012-2013, daily cash margin requirements for clearing participants would have been reduced by 20-30%.

Liquid Capital

ASX also notes that liquid capital requirements for participants may be able to be reduced if T+2 goes ahead.

Clearing Fees

ASX has noted that, subject to ASIC and RBA permitting it to reduce the amount of paid-in capital that ASX must set aside for participant default, T+2 settlement may also allow ASX to reduce the clearing fees it charges participants. As clearing fees have not seen the same influence of competition as trading fees in recent years, Members would be very pleased to see the possibility of reductions in the cost of clearing.

Obviously, brokers would welcome reductions in regulatory capital requirements and fees. It would be better for everyone if ASX held less cash margin, as the capital could be better employed elsewhere.

b. Risk Reduction

As discussed in the GBST Paper, as well as lower costs, there would be less **risk**, both settlement and operational. T+2 should force more automation in settlement, and hopefully this would reduce risk. This would be better for brokers, clients and the market as a whole. The real benefits of this may not be seen until the next market

disruption or Crash. If anything, some of our members thought that the GBST Paper possibly *understates* the benefits from the reduction in risk that a move to T+2 settlement would bring.

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?*

IT System changes not major: it is thought that while changes will be needed to settlement and operations systems for a move to T+2, such changes to IT systems themselves will not be major.

However, further costs will arise from implementation in changes to policies and procedures and client relations, including client agreements if necessary.

Reduction in Fail Fees? ASX should consider a reduction or moratorium on fail fees for a period after implementation of T+2 in order to facilitate an orderly transition.

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?*

As to timing, we note that Europe is mandating 1 January 2015 for the introduction of T+2. Some members would be prepared for transition by this date, but by no means all, especially those whose clients include intermediaries like financial planners or shadow brokers.

The different approaches of the EU (T+2) v. the US (T+3) will be highly relevant. However, it seems likely that, buoyed by the favourable cost/benefit analysis of *Boston Consulting* for the US Depository Trust and Clearing Corporation and noted in the GBST Paper, the US will eventually move to T+2. However, until they do, any move to T+2 in Australia may cause problems for US clients. Closer to home, several markets in our region (notably Hong Kong) have already moved to T+2, which should also encourage the Australian move.

Any move to T+2 settlement will need to be accompanied by an adequate **transition period** in order to address all of industry's issues, some of which may not yet even have arisen. In retail broking in particular, moving any earlier than 1 January 2016 may cause significant problems.

Accordingly, as it would be very difficult for the whole industry and their clients to be prepared by 1 January 2015, a start date of 1 January 2016 would appear to be more appropriate and achievable.

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

Yes

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.*

Later Batch Time: with any move to T+2 the consensus is that batch settlement also be delayed, from the current 10:30am on T+3 to a time between up to 1pm on T+2. It may help if CHES could provide some data on the times that CHES processing has been completed over the last 5 years to use as a guide. A later batch time would allow longer processing time, particularly for operations/clients/custodians that are Hong Kong or Singapore-based, and allow the opportunity for last-minute changes.

Q19 *Would extending the CHES 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?*

Yes, extending opening and/or closing times of the CHES system may help to achieve timely settlement.

We also note that any move to extend the SWIFT opening times may also help, especially with offshore custodians, as it is restrictive that it currently opens at 9:15am AEST.

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?*

Yes, lack of access to stock borrowing is a key factor in settlement failure. Consideration ought to be given to the re-introduction of the ASX sponsored stock loans facility for a reasonable fee, even if it is for a short period of time after implementation of T+2 to assist in an orderly transition.

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?*

It would seem logical for the T+5 close out rule¹ to be changed to settlement date +1 (T+4) in view of the change in settlement to T+2. While this takes into account the shorter settlement period for on-market acquisitions, in practice the timing for stock loans may vary.

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

As a fall-back process in times of likely default, it may be useful for participants to have access to RTGS. ASX should consider offering incentives in lower fees for the service, especially during transition.

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*

A Second Batch? There has been some discussion about implementing a second batch on T+2 at say, 4pm, in case participants miss the main batch. While in practice this may be of assistance to Members, there is also the view that it may encourage laxity and inefficiency, with brokers in practice moving some or all their processing to the later time. Having to have staff available for a Second Batch would itself introduce costs and administrative burdens on brokers. As it would affect all brokers, this may not be a

¹ ASX Settlement Operating Rule 10.11.12

desirable outcome. Indeed, it has been said that it would detract from the whole move to T+2. Accordingly, if a Second Batch is considered, it probably should be accompanied by strong incentives to make the First Batch, in terms of fees, etc.

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?*

Yes, as mentioned in our response to Q24, material additional costs or regulatory considerations caused by a Second Batch may detract from the whole move to T+2.

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?*

Yes, the education of clients is going to be crucial in relation to the transition to T+2. Age-old practices, like paying by cheque or delayed allocations of institutional trades, will no longer be possible. ASX should therefore undertake a general education program for all investors, and incorporate it in the *Shareholder Ownership Survey* as appropriate. This would lift the burden on individual brokers to educate clients.

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)?*

Yes, with the shorter settlement cycle, any extra time for participants will ensure a higher rate of successful processing.

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?*

While our Members are better placed to comment on the precise effect, generally securities lending will be impacted since it will need tighter processing and administration.

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

Operations, Policies and Procedures: As noted in the Consultation Paper, there will inevitably need to be other changes in the way business is done, which will impact operations and clients. In **Retail**, T+2 would effectively put an end to accepting payment by cheque and mailing hard-copy confirmations. In **Institutional**, the allocation and booking process would need to be tightened, which would probably mean automation. Like the changes occasioned by the move from T+5 to T+3, these changes will be an administrative and cost burden to brokers in the short term, and may cause some inconvenience to clients. However, on balance, and looking at the longer term, these changes - especially automation – should eventually lead to lower costs and lower risk.

NZ dual-listed stocks (e.g. Telecom NZ): it would cause issues for the settlement of dual-listed stocks if New Zealand were to remain at T+3 settlement and Australia moves to T+2. It is therefore hoped that the matter will or has been raised at a high level with NZX as a matter of urgency. However, while it would be preferable to have NZ on board, if it decides not to move to T+2 at the same time as Australia, this should not impede the Australian market from moving.

Rule amendments: there will need to be many changes and consequential amendments to the ASX Settlement and ASX Clear Operating Rules in order to implement T+2, including the time-based rules like automatic close-out (ASXS OR 10.11.12).

Client Agreements: brokers may need to amend their Terms of Business if they specifically refer to times on a Trade date basis (e.g. T+2 / T+3). This may also affect confirmations.

Retail – Clients with multiple accounts/SRNs: in retail it is not uncommon to have a client that has a CHESS account at one broker and sells through another broker. This requires an instruction to the CHESS broker to deliver to the other broker for settlement. The sponsoring broker has 2 days to do this, which would often mean that the other broker would not deliver in time for settlement on a T+2 basis (unless this is done before the trade). Of course rationalising client accounts to one firm would be a good thing operationally, but it may impact on the client's freedom of choice, and ability to deal through more than one broker.

Concluding Remarks

In Summary, although **Retail** would have to change processes and clients' mindsets (e.g. electronic confirmations only, direct access to CMT/CMA, and no more cheques), and **Institutional** brokers will have the issue of delays in advising allocations by overseas clients and/or custodians, overall it is thought that the move to T+2 would be beneficial for the industry.

While the benefits of T+2 in terms of risk and regulatory capital – including lower cash margining – discussed in the Paper are considerable, obviously there will be some substantial issues to be addressed before the whole industry is comfortable.

Finally, it is hoped that **custodians and share registries** will be as prepared for the move to T+2 as brokers and clearers, since many of the settlement issues that arise are caused by inefficiencies outside of the brokers' and clearers' control. These parties will also need to upgrade processes and systems accordingly.

Thank-you for the opportunity to present these comments for consideration by the Exchange in making the proposed changes. Thank-you also for making your senior officers available to us and our Members to meet and discuss these matters at our recent Member Forum and during your extensive consultation.

Should you require any further information, please contact me or Doug Clark, Policy Executive on dclark@stockbrokers.org.au.



David W Horsfield
Managing Director/CEO
Stockbrokers Association of Australia
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