



Room 525, 5/F., Prince's Building, Central, Hong Kong
Telephone: 2521 1160, 2521 1169 Facsimile: 2868 5035
Email: info@hkab.org.hk Web: www.hkab.org.hk

香港中環太子大廈5樓525室
電話：2521 1160, 2521 1169 圖文傳真：2868 5035
電郵：info@hkab.org.hk 網址：www.hkab.org.hk

26 February 2010

By post

Corporate Communications Department
Hong Kong Exchanges and Clearing Limited
12th Floor, One International Finance Centre
1 Harbour View Street
Central
Hong Kong

Dear Sirs

**Consultation Paper on Introduction of a T+2 Finality Arrangement for
CCASS Money Settlement – November 2009 (“Consultation Paper”)**

The Hong Kong Association of Banks (HKAB) is pleased to be involved in the soft consultation through its Technical Operations Committee (which comprises 10 HKAB members all of which are Designated Banks of varying sizes) prior to the publication of the above Consultation Paper by the Hong Kong Securities Clearing Company Limited (HKSCC). Based on the recommendation of the Technical Operations Committee after careful study of HKSCC's reply to HKAB dated 20 October 2009 (HKSCC Reply) in response to our comments made during the soft consultation and the formal proposals in the Consultation Paper, HKAB is pleased to submit further comments which are set out in this response.

Question 1

**Do you support the implementation of the proposed T+2 Finality arrangement?
If not, what are the reasons?**

We wish to reiterate our in-principle support of the proposed T+2 Finality arrangement to align with international best practices, thereby maintaining Hong Kong's position as a major international financial centre.

Chairman Standard Chartered Bank (Hong Kong) Ltd
Vice Chairmen Bank of China (Hong Kong) Ltd
The Hongkong and Shanghai Banking Corporation Ltd
Secretary Rita Liu

主席 渣打銀行（香港）有限公司
副主席 中國銀行（香港）有限公司
香港上海匯豐銀行有限公司
秘書 廖碧瑩

1



Question 2

Do you envisage any problems or concerns for you or your company to operate under the proposed T+2 Finality arrangement? If yes, what are the problems and how can the arrangement be refined to help address your problems?

- A. Based on the T+2 Finality arrangement proposed in the Consultation Paper, we anticipate the following challenges for Designated Banks and market participants and would urge HKSCC to further explore workable alternatives / options with the Hong Kong Monetary Authority (HKMA), HKAB, Hong Kong Interbank Clearing Limited (HKICL) and relevant stakeholder groups:
1. Insufficient time for credit assessments by Designated Banks – We wish to reiterate that Designated Banks of CCASS Participants require 2 to 3 hours to process the settlement instructions, ascertain customers' funding positions, communicate with customers as required, make prudent credit assessment and confirm rejection of specific settlement instructions in time. Under the detailed operational flow proposed for the T+2 Finality arrangement, Designated Banks have at most one hour and possibly 45 minutes to complete this process (see also our comments in B4 below). The proposed window is too short and obviously insufficient for Designated Banks to effect a prudent credit decision even in normal circumstances. This would have significant impact to Designated Banks in terms of credit risk exposure and in turn introduce unnecessary uncertainty and systemic risk to the Hong Kong financial market. This is explained further below.
 2. Funding of CCASS Participants – Many international brokers are funding their cash position through inward remittances, the proceeds of which are credited to their accounts between 6 – 8 p.m. The exclusion of these activities under the proposed time window would present liquidity issues for these market participants which in turn would impact the credit decisions of their Designated Banks.
 3. Share financing – It is common for local brokers to arrange share financing with their Designated Banks through the CCASS settlement batches. Where the settlement of these transactions takes place within the 3:45 p.m. settlement batch, it would be necessary for Designated Banks to update their systems for calculation of positions / credit exposures, in time for making credit decisions. Designated Banks therefore need sufficient lead time to make the necessary system enhancements to cope with the requirements.



4. Recycling of CCASS money back to the inter-bank market – As proposed in the Consultation Paper, CCASS money settlement instructions will be completed at 6:00 p.m. when interbank activities are thin. This would make it difficult for banks to effectively recycle the money back to the market and this could have knock-on effect on the stability of the Hong Kong money market particularly where the money settlement of such placement activities is significant.

In addressing the above concerns, we would urge HKSCC to work with the HKMA, HKAB and HKICL to develop and agree on a workable and practicable processing window for Designated Banks. In this regard, we propose that the joint study should include at least the following options:

- (i) Advancing the time of receipt of money settlement instructions by Designated Banks from 4:20 p.m. to, say, 4:05 p.m. - It is stated in the HKSCC Reply that a built-in buffer of 10-15 minutes is purposely allowed for CCASS to operate at full capacity (i.e. to support 5 million exchange trades per day as compared to the current level of less than 800,000 trades per day). We urge HKSCC to reconsider the necessity and amount of the buffer required to accommodate a realistic volume increase over the next 3 years by which time the overall interbank and RTGS operations as well as HKSCC technology advancement may present a different environment. Any additional time allowed to Designated Banks (by making available the money settlement information earlier) will enable them to expedite the determination of customers' funding positions and, where the accounts have insufficient funds to meet the payment obligations, contact the customers concerned at an earlier time.
- (ii) Extending the interbank clearing run – We are conscious that any extension in customer and inter-bank cut-off schedules for CHATS payments in Hong Kong dollar will impact the CHATS payments in other currencies. The impact on the banking operation, particularly the treasury operations, will have to be carefully assessed by member banks. In light of HKSCC's response to the suggestion in (i) above, the magnitude of the extension required in the customer and inter-bank cut-off schedules can then be ascertained and the potential impact of such extension carefully assessed by HKAB, the HKMA and HKICL.



B. We also wish to seek clarifications on certain proposals contained in the Consultation Paper.

1. Proposed Arrangement Details (paragraphs 26-34). The new money settlement arrangement has potential implications for Designated Banks and CCASS Participants, discussed further below.

The proposed operational model may affect the processing commitment of all CCASS Participants. We believe HKSCC has a key role in working with HKICL and Designated Banks to conduct a comprehensive review of the rules, agreements and other documentation binding on CCASS Participants. In particular, for operational and cost efficiency, HKSCC proposes Designated Banks to receive the settlement instructions from CCASS (instead of through its Agent Bank as at present) and to input rejected items to CCASS direct (instead of to HKICL). The proposed changes would have clear legal implications for Designated Banks in case of errors in the information that is received from HKSCC and processed by them (see also our comments in B(4) below). We understand from HKICL that it will enter into a service agreement with HKSCC (being a non-Clearing House member) but the service agreement will not involve any commitment by HKSCC to clearing members to comply with the Clearing House Rules issued by HKICL. This is undesirable from the perspective of individual clearing members in pursuing claims as required. This is an outstanding issue and needs to be satisfactorily addressed before the implementation of the T+2 Finality arrangement. HKAB is committed to work with HKSCC, the HKMA and HKICL in such regard.

2. Coverage of CNS, IT and SI transactions under the proposed T+2 Finality Arrangement (paragraphs 26 and 27) – We suggest that HKSCC consider including nominees monies (for IPs) under the proposed T+2 Finality Arrangement for the following reasons:
 - This will minimize system developments for both custodians and market participants.
 - Nominees monies are mainly corporate action-related entitlements to be distributed and, to a lesser extent, corporate action-related payments. The earlier receipt of such funds on T+2 would facilitate liquidity management for market participants and brokers while there should be no impact on companies which are currently obligated to distribute entitlements to HKSCC by T+2.



3. Paragraph 28 – *At around 4:30 pm after the completion of the final batch settlement run, money settlement instructions will be generated by CCASS and transmitted to HKICL for the interbank bulk clearing processing. It is not clear whether the processing of DDI/DCI generated by CCASS direct instead of through its Agent Bank as at present would have a potential volume / processing implication for HKICL. For the avoidance of doubt, this should be stated clearly in the relevant documentation.*
4. Paragraph 29 – *Designated Banks can choose to download money settlement instructions directly from CCASS at 4:20 p.m. through their CCASS Terminals or from HKICL at around 4:35 pm through its File Transfer Service. It appears that it is at the discretion of Designated Banks whether to receive the money settlement instructions from CCASS or from HKICL. This would be undesirable where there are discrepancies between the two files, with potential ramifications on inter-bank settlement. We suggest that it is only fair on Designated Banks to be entitled to treat the information received from CCASS as final and correct and be appropriately indemnified in case of claims made against them because of errors in the CCASS information. We would ask HKSCC to confirm our understanding and reflect this in the appropriate rules and documentation involving HKSCC and Designated Banks.*
5. Paragraph 34 – *In the unlikely case that money settlement instructions cannot be settled in the new interbank bulk settlement run (e.g. due to system or link failure), the relevant instructions will be batched with other items for settlement in the following interbank bulk settlement run at 9:30 am in the morning of T+3. As explained in our response to Question 1 above, the proposed window allowed for Designated Banks is not practicable and this challenge is increased where there is a system hiccup in one or more of the Designated Banks. HKAB will be pleased to engage in further discussion with HKSCC in developing and agreeing on practicable contingency plans in various scenarios.*

Question 3

What is the estimated lead time required by you or your company to prepare for the implementation of the proposed T+2 Finality arrangement? What are the major preparations required?

We suggest HKSCC allow at least a 10-month lead time for Designated Banks to plan and implement any necessary system enhancements to cater for the implementation of the proposed T+2 Finality arrangement.



Question 4

Do you have any other comments in relation to the introduction of a T+2 Finality arrangement for CCASS money settlement?

In addition to the issues set out in our response to Question 2 above, we consider that the following matters merit the consideration of HKSCC:

1. Public Consultation / Education - The proposed changes to the CCASS money settlement arrangement will not only affect the operations of brokers and all CCASS participants but also global custodians and investors. There is merit to extend public consultation to International Organization of Securities Commissions (IOSCO), Global Custodian Panel and relevant overseas professional bodies. Furthermore, we believe that the work plan of HKSCC should allow some form of public education programmes prior to the implementation of the T+2 Finality arrangement to ensure investors are aware of the implications and the new practice they should adopt, including ensuring the funds required are made available sufficiently early in their accounts.
2. Trial-run / Phased Approach – To ensure the detailed operational flow is workable, we propose HKSCC to consider a trial run or a phased approach and, in light of experience and statistics collected regarding the settlement failure rate and broker default rate, decide on the timing of the full launch of the T+2 Finality arrangement. Further, we support HKSCC consider conducting a review of the new arrangement after it has been implemented after a period of time. This review will facilitate evaluation of the effectiveness of the new arrangement and help identify potential areas of enhancement.

We hope HKSCC find the above comments to be useful. HKAB will be pleased to organise a meeting for HKSCC to meet with the Technical Operations Committee to elaborate on issues discussed in this response, prior to HKSCC finalizing and issuing the consultation conclusions.

Yours faithfully

Secretary

c.c. Hong Kong Monetary Authority
Hong Kong Interbank Clearing Limited