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BACKGROUND AND CURRENT STATUS

A. The Purpose of this Report

Previous consultations with market practitioners in the Association of Southeast Asian Nations+ the People's Republic of China (PRC), Japan, and the Republic of Korea (ASEAN+3) region led to the view that the absence of a cohesive linkage of bond clearing mechanisms in the region is adversely affecting cross-border investments and thus the development of domestic and regional bond markets. As a consequence, the Foreign Exchange Transactions and Settlement Issues Working Group (Working Group 3) requested ADB to help identify the options and make recommendations for effectively accelerating the linkage of domestic settlement and payment systems to facilitate enhanced cross-border investment. The development of the bond market is, according to practitioners, constrained by the lack of a regional clearing and settlement facility, but the lack of products to trade and thus the lack of volume of trading interest means that the links that have been established are hardly used and that commercial organizations have no incentive to develop links as they cannot operate at a reasonable cost with very low volumes.

Nevertheless, the purpose of the Asian Bond Market Initiative (ABMI) is to increase the supply of bonds in the region by developing new types such as asset backed securities, to increase the market for such bonds by developing credit rating agencies, and to increase the interest in the market through developments such as the website. In the settlement area too, we must therefore think not only about the current situation but also about the future needs of the market.

B. The Importance of Settlement Systems for Securities Markets

Well-functioning settlement systems are a prerequisite for efficient securities markets. The lack of a secure and efficient settlement system operating at a reasonable cost can significantly affect investors' confidence and hence can hinder the development of the securities markets both in terms of volume and quality. This point is summarized in several authoritative reports. Functioning as an advisory group to the European Union (EU), the Giovannini Group¹ published the now-famous Giovannini Report on clearing and settlement issues.² It says that the. "...clearing and settlement process is an essential feature of a smoothly functioning securities market, providing for the efficient and safe transfer of ownership from the seller to buyer."³ The Japanese Financial Council has also published a report that focuses on the importance of buy-side confidence in the settlement system. It states that, "The investors begin to trade the securities positively after they trust the safety and efficiency about the settlement. In this sense, the securities settlement system is an important base in the securities market."⁴

C. Summary of the Current Status in ASEAN+3

With a very few exceptions settlement systems in the region are national, i.e., each country has its own settlement arrangements for different types of instruments, and participation in these systems is generally limited to locally regulated participants. As a general rule, government (and quasi-government) bills, bonds, and notes are traded over the counter (OTC) between banks (interbank market) and settled through settlement systems operated by the central bank. These systems do not provide a guarantee (i.e. do not link with a clearing company or a central counterparty) but do have a link for payment into real time gross settlement (RTGS) systems, where these exist. Corporate bonds (CBs), where they exist, are generally listed and traded on the national stock exchange and

¹ A group of financial-market participants, under the chairmanship of Alberto Giovannini.

² See http://europa.eu.int/comm/economy_finance/giovanni/clearing_settlement_en.htm

³ Ibid.

⁴ Japanese Financial Council Report., June 2000.

settled through the central clearing and depository systems associated with that exchange.

When regional governments, supranational bodies and corporations issue bonds in international currencies (e.g. US dollars, euros, yen, and sterling), these bonds may be issued in the international market and settled through one of the international central securities depositories (ICSDs), i.e., Euroclear or Clearstream, and/or they may be listed on the stock exchange in the country whose currency is used (e.g. Yankee bonds and Samurai bonds) and settled through the central securities depository system (CSD) linked with the relevant exchange.

Many of the CSDs are linked with ICDs. This is more to enable international market participants to trade and settle local government bonds than to facilitate local market participants trading and settling international bonds. Within the region, there are currently only a few links and those that do exist are used very infrequently. Table 1 provides a summary of the bond settlement systems in the region, both for government and corporate bonds, and the links between national systems. Annex A details the bond settlement systems that operate in the countries covered by this report and the links between systems within each country and externally.

Table 1: Summary of Bond Settlement Systems in the Region

	People's Republic of China	Hong Kong, China	Indonesia	Japan	
Settlement Organization for Government Bonds	China Government Securities Trust and Clearing Company (CDC)	Central Moneymarket Unit (CMU) of the Hong Kong Monetary Authority (HKMA).	Scripless Settlement System (SSS) owned and operated by Bank Indonesia.	Bank of Japan-NET JGB Services owned and operated by the Bank of Japan.	
Settlement Organization for Unlisted Corporate Bonds	CDC	CMU (although direct counterparty settlement is also possible.)	Directly between the counterparties by re-registration at the nominated transfer agent.	Counterparties settle transactions at registrar banks using Japan Bond Settlement Network (JB Net). A book entry system will be set up in January 2006.	
Settlement Organization for Bonds Traded on a Stock Exchange (Government and Corporate)	China Securities Depository and Clearing Corporation (SD&C)	Central Clearing and Settlement System (CCASS), which is wholly owned by Hong Kong Exchanges (HKEx).	Indonesia Central Securities Depository (KSEI).	Bank of Japan-NET JGB Services for listed JGBs; Delivery of physical certificates for listed corporate bonds	

	Malaysia	Philippines	Singapore	Republic of Korea	Thailand
	Scripless Securities Trading System (SSTS). This is part of the RENTAS system owned and operated by Bank Negara Malaysia.	Registry of Scripless Securities (ROSS) operated by the Bureau of Treasury, which is part of the Department of Finance.	MAS Electronic Payment System – delivery versus payment (MEPS-SGS) operated by the Monetary Authority of Singapore (MAS).	Korea Securities Depository (KSD) operated by the Korea Stock Exchange (KRX).	The Bond Registry System and the book entry system at the Bank of Thailand (Bank of Thailand), government bonds in the book entry system are settled through BAHTNET, which is operated by the Bank of Thailand.
			Debt Securities Clearing and Settlement System (DCSS) operated by the Stock Exchange of Singapore (SGX).	KSD operated by KRX.	Counterparties make their own direct settlement arrangements.
	Malaysian Central Depository (MCD), which is owned and operated by Bursa Malaysia.	Philippines Central Depository (PCD).	Debt Securities Clearing and Settlement System (DCSS) operated by the Stock Exchange of Singapore (SGX).	KSD operated by KSE.	The Thailand Securities Depository Co., Ltd. (TSD), a subsidiary of the Stock Exchange of Thailand (SET), facilitates the book entry system for the dealers to settle listed corporate bond.

Table 1: (continued)

	People's Republic of China	Hong Kong, China	Indonesia	Japan	
Link Between Organizations	SD&C performs settlement of stock exchange transactions. However CDC maintains the master record for government and corporate debt (other than convertible bonds listed on an exchange) and therefore SD&C records are sub-accounts of CDC records.	CCASS is responsible for settlement of stock exchange transactions. However CMU maintains the master record for government bonds and therefore CCASS records are sub-accounts of CDC records for these securities.	KSEI is one of 10 sub-registries in the scripless securities settlement system. The other sub-registries are private sector banks.		
International Links used for settlement	CDC has one-way links with HK CMU. CDC participants can settle CMU eligible securities and use the CMU links with other international organizations.	CMU has two-way links with Euroclear, Clearstream, Austraclear (New Zealand), KSD; one-way, outward links with Austraclear (Australia); and one-way, inward links with CDC.			

	Malaysia	Philippines	Singapore	Republic of Korea	Thailand
		ROSS is a direct participant of PCD		The same organization (KSD) is used for both types of bonds.	
			Central Depository (Pte) Ltd. has bi-lateral links with Japan Securities Settlement and Custody (JSCC) and unilateral links with Clearstream, DTCC (US) and Shenzhen Securities Registrars Ltd.		