

Common Platform Model for Asia: a collaborative effort to improve the post-trade processing infrastructure for debt securities in Asia

by the Financial Infrastructure Department

A Task Force comprising the Hong Kong Monetary Authority, a group of central banks and central securities depositories (CSDs) in the Asian region, and Euroclear has recently issued a White Paper, recommending the development of a Common Platform Model in the long run to improve the cross-border post-trade clearing and settlement infrastructure for debt securities in Asia. This article explains the background, initiatives put forward in the White Paper and their benefits to Hong Kong and the region as a whole.

Introduction

A deep and efficient bond market brings benefits to Asian economies in terms of greater monetary and financial stability, and further development of the capital markets. Although policymakers in the region see the importance of and priority for further development of the Asian bond markets, there are many factors hindering the growth of the bond markets in the region. These factors include, among others, infrequent and small issue size of government bonds compared with other regions, high reliance by corporations on bank loans and equity markets, regulatory restrictions to foreign investments, and an inefficient post-trade infrastructure. In fact, inefficiencies in post-trade infrastructure coupled with market fragmentation and lack of automation and harmonisation of the post-trade processes are the major barriers to enhancing the attractiveness of local bonds to international and regional investors. A more efficient post-trade infrastructure is therefore needed to create the right environment to facilitate the development of the Asian bond markets.

Against this background, a Task Force was formed with a view to facilitating the Asian bond market development and enhancing the attractiveness of Asian debt securities to foreign investors through the

development of a cost-effective and efficient post-trade infrastructure. The Task Force comprises representatives from the Hong Kong Monetary Authority (HKMA), Bank Negara Malaysia (BNM) and Euroclear, with representatives from Bank Indonesia and the Bank of Thailand as observers. Following a series of meetings and discussions, the Task Force has reached a consensus that a Common Platform Model, which serves as a basis for co-operation among CSDs from different economies and Euroclear, is necessary; and a gradual implementation approach is appropriate for Asia given the differences in financial, regulatory and currency regimes among Asian markets. As a result, the Task Force issued a White Paper entitled “Common Platform Model for Asian Post-trade Processing Infrastructure” on 4 June 2010 to set out the long-term development blueprint of the post-trade cross-border clearing and settlement infrastructure for debt securities in Asia. In formulating this White Paper, the HKMA has taken the initiative to consult the other central banks in the region.

The Common Platform Model

Currently, CSDs in the region share some similar comparative disadvantages. For example, only a few

CSDs in the region have the capability to provide delivery-versus-payment¹ (DvP) settlement for local debt securities denominated in foreign currencies, with the Central Moneymarkets Unit (CMU) operated by the HKMA, and the Central Clearing and Settlement System operated by the Hong Kong Exchanges and Clearing Limited being two of them. The different practices and standards for post-trade processes across Asian markets also made it difficult for CSDs to implement straight-through-processing, resulting in less efficient operations. Yet, the weakest area among Asian CSDs is asset servicing. Many CSDs in the region have not implemented centralised databases for securities and corporate actions. Even for those which have already implemented such databases, asset-servicing processes (including payment of income and redemption, and announcement and processing of corporate actions) are still unharmonised and often manual, which inevitably increase the operational risks of the CSDs.

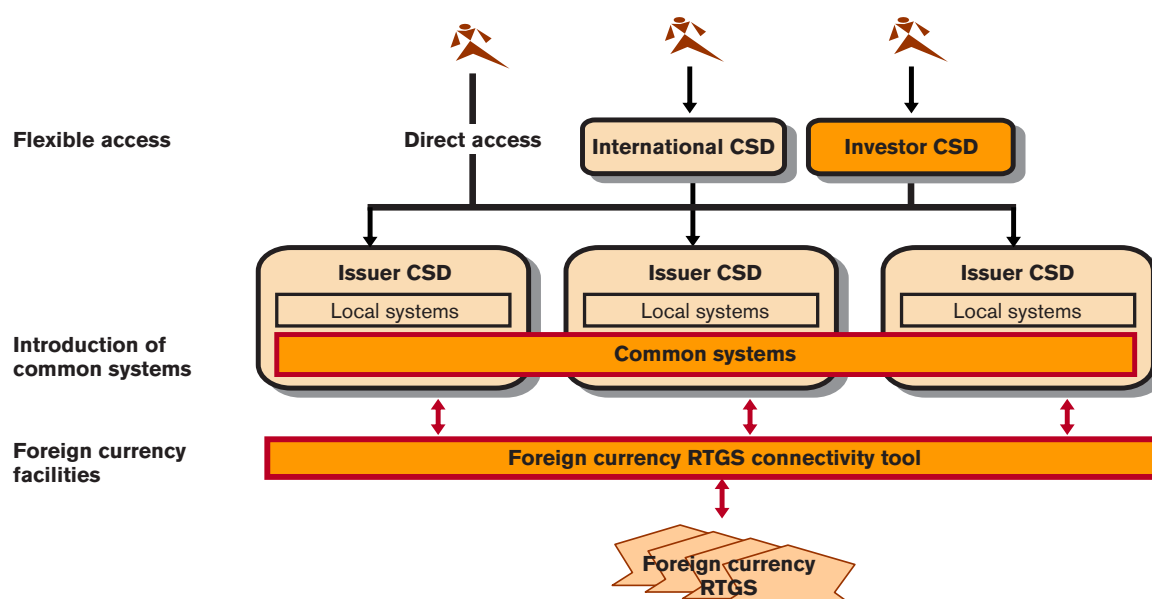
Members of the Task Force envisage that a common infrastructure platform will help address the needs in

Asia. These needs include cross-border access to local Asian bonds, stimulation in local bond issuance, automation of the post-trade process to minimise operational risk, possible cross-border collateralisation of exposures to reduce credit risk and to increase access to liquidity, and reduction in post-trade costs. Drawing reference from the European experience and taking into account the Asia-specific requirements, members of the Task Force recommended the development of a Common Platform Model in the region to improve cross-border access and provide common asset servicing, common collateral database to facilitate pooling of collateral as well as common DvP settlement processes for cross-border transactions and for securities denominated in Asian and major international currencies. Diagram 1 gives an overview of the components of the proposed full-fledged Common Platform Model in the long term.

One main objective of the Common Platform Model in vision is to introduce common systems and processes as well as a common securities and corporate action database across markets in Asia to

DIAGRAM 1

The Common Platform Model for Asia



Note: Elements in orange background represent new functions or common systems.

¹ DvP is a securities delivery arrangement in which the delivery of securities takes place as soon as payment is made for them and confirmed final and irrevocable.

promote efficiency. The Common Platform can be regarded as a “common steward” serving the central banks and CSDs in the region. CSDs using the Common Platform will retain their responsibility for ownership of local securities, including safekeeping and record keeping, the business operations (on both local and common systems) and direct client relationships. In other words, the ultimate goal of the Common Platform Model is to provide better services to the local CSDs, and to provide a more efficient common post-trade infrastructure through harmonised processes and standards across the Asian markets.

The Common Platform Model also aims to provide cross-border investors with flexible access to Asian bond markets, saving the need to open accounts directly with the respective issuer CSDs.² The three different options for cross-border investors to access an issuer CSD in the region include:

- (1) Direct access, if allowed under the local rules and regulations of the respective jurisdictions.
- (2) Indirect access through an international CSD (ICSD), if connections are established between the ICSD and the respective issuer CSDs.
- (3) Indirect access through an investor CSD³, if the investor CSD has a direct connection with the respective issuer CSD or an indirect connection through an ICSD or an intermediary CSD.

In addition, the Common Platform Model offers a facility for the issuers to issue local bonds in major foreign currencies if the respective local settlement systems in Asian markets provide foreign-currency clearing and settlement, or connect to the foreign-currency Real Time Gross Settlement (RTGS) systems in the region, such as the RTGS systems in Hong Kong, which offer the clearing and settlement in Hong Kong dollars, US dollars, euro and renminbi. This facility will help issuers to attract investments in

their local bonds from investors who are less inclined to take local currency risk. This also enables cross-border DvP settlement for foreign-currency denominated bonds during Asian time zone.

While the Common Platform Model will help address the identified needs, the introduction of harmonised processes and common systems in Asia will require time and effort. Members of the Task Force therefore consider it more appropriate to adopt a gradual approach and introduce a Pilot Platform in the near future in order to gradually migrate to the Common Platform Model in the longer term.

The Pilot Platform

The introduction of a Pilot Platform is a tactical solution to deliver early benefits of the Common Platform Model before its full implementation. The Pilot Platform will leverage the existing services and systems used by Asian CSDs and the ICSD to facilitate cross-border investment activities in Asia and attract more international investments into the Asian markets. The main objective of the Pilot Platform is to ensure that the developments and changes to local practices, regulations and laws are kept at a minimal level, and that the Pilot Platform can bring in some quick wins with limited upfront investment and risks.

As shown in Diagram 2, the essential components of the Pilot Platform are similar to that of the Common Platform Model and form the foundation of the Common Platform Model. The Pilot Platform does not yet have the common systems to undertake asset servicing and collateral management. Instead, local CSDs can leverage their respective links with the ICSD for conducting such services. The remaining basic functions of the Common Platform Model, including the different access options, the cross-border holding of securities, as well as the issuance and DvP settlement of debt securities in local and foreign currencies can all be achieved by the Pilot

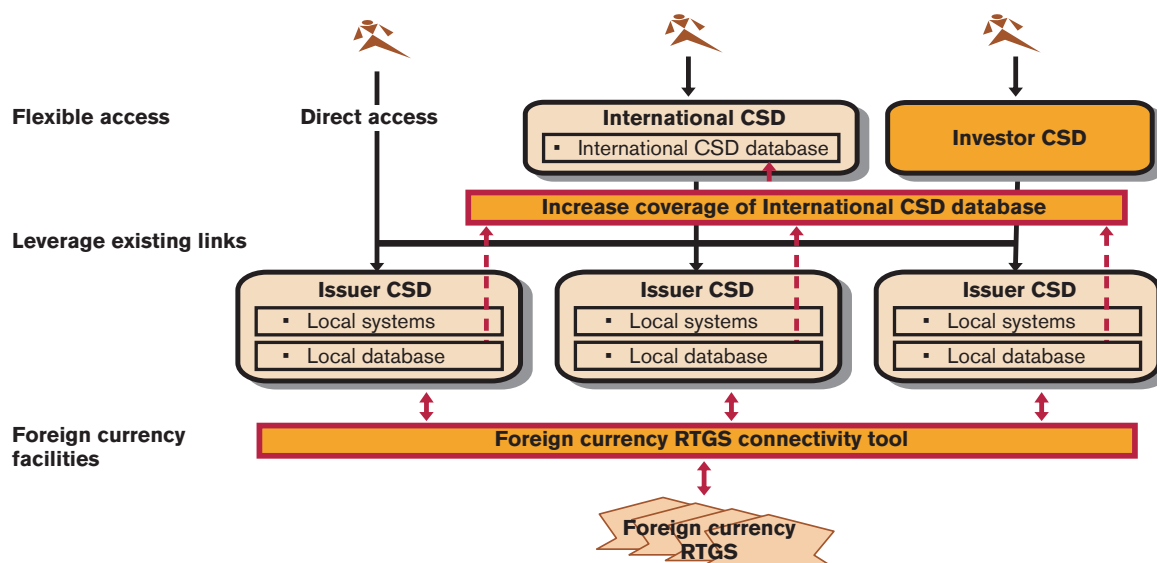
² An issuer CSD is the CSD holding the local securities.

³ An investor CSD is the local CSD, or any other local entity other than CSDs that has the right and the capacity to offer

settlement and asset servicing on foreign securities to local financial institutions. It can hold foreign securities on behalf of its local clients, thus leveraging local infrastructure to provide access to foreign securities.

DIAGRAM 2

The Pilot Platform



Note: Elements in orange background represent new functions provided by the Pilot Platform.

Platform. It is important to note that service improvements, and harmonisation of the standards and market practices in relation to the issuance, clearing and settlement of Asian debt securities can be continued even after the launch of the Pilot Platform, so as to facilitate the gradual migration to the Common Platform Model in vision.

The Task Force plans to launch the Pilot Platform in the first half of 2011. The HKMA, together with BNM and Euroclear, will join the Pilot Platform as early movers. By then, investors in Hong Kong and Malaysia can hold foreign securities through their local CSDs and settle cross-border transactions denominated in both local and major foreign currencies (e.g. US dollar, euro and renminbi) on a DvP basis within the Asian time zone. Other central banks and CSDs in the region can also join the Pilot Platform as and when they are ready and decide what securities to be put onto the Pilot Platform according to their own market development and needs.

Benefits to Hong Kong and the region

The initiatives put forward by the Task Force allow Asian CSDs to adopt a set of harmonised

procedures and shared technology for debt securities processing in a gradual and co-ordinated manner, without interfering with their existing set-up and autonomy. The Common Platform Model is open and flexible, making it easy for economies at different stages of development to join as and when they are ready. The early delivery of the Pilot Platform provides a timely solution to the immediate and near-term needs of the regional financial markets, including that generated by the rise of renminbi as an international trade settlement currency, i.e. the need for more efficient cross-border cross-currency collateral management and more cross-border trading and settlement of renminbi bonds issued in Hong Kong.

Regionally, the increasing trend of collateralised lending and greater needs for cross-border collateral management among Asian economies in the current financial environment calls for the delivery of an infrastructure that can help alleviate financial institutions' liquidity pressure, especially during times of crisis. The Pilot Platform is well positioned to serve this need as it enables Asian financial institutions and central banks to access a larger pool of collateral to support multiple exposures, and foreign institutions to increase the usage of Asian local bonds as collateral.

In the context of Hong Kong, CMU, the clearing, settlement and custodian system for debt securities in Hong Kong operated by the HKMA, can enjoy the synergy and harmonised market practice as a result of the platform-sharing. It can also leverage the functionalities of the Pilot Platform to provide more efficient cross-border collateral management. These, coupled with Hong Kong's existing multi-currency and multi-dimensional payment and settlement infrastructure, can attract more regional banks to use Hong Kong's payment platform, thereby reinforcing Hong Kong's role as a regional payment and settlement hub.

The way forward

The Pilot Platform marks the beginning of a long-term vision to improve the post-trade environment in Asia. Its implementation is believed to induce momentum for other CSDs in the region to join, increase the attractiveness of the Asian bond markets to international investors and set a precedent for other economies. Going forward, members of the Task Force will continue to co-ordinate further developments of the Platform and turn it into a more integrated and harmonised solution in the longer term. The Task Force welcomes comments on the initiatives and encourages other interested central banks and CSDs to participate in the Task Force. These co-ordinated efforts will help unify the various market practices into a common set of procedures, which are conducive to the successful transition from the Pilot Platform to the ultimate Common Platform Model in vision.