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AGENDA

FMOA CONFERENCE & AUSTRACLEAR USER GROUP MEETING

Friday 27 May 2005

BNZ Tower, Level 3,
125 Queen Street, Auckland

10.30am - 10.55am Registration/Morning Tea

11.00am – 11.40 am
Challenges Facing Auckland Businesses
Michael Barnett, CEO,
Auckland Chamber of Commerce

11.45am – 12.15pm
Task Force for Regulation of Financial Intermediaries
Michele Stanton, Managing Director,
Glaister Ennor Asset Management Limited

12.30 – 1.30pm Lunch

1.45pm – 3.00pm
Austraclear Users Group Meeting

3.00pm – 3.15pm
Update from CSD Working Group
Robert Poulter, Chairperson FMOA

3.15pm - 3.40pm Afternoon Tea

3.45pm – 4.25pm
IRD Presentation
Marie Pallot, Inland Revenue Department

4.30pm – 5.00pm
Broking in New Zealand and changes in the New Zealand Broking Industry
Tim Preston, Managing Director
ASB Securities Limited

5.15pm – 7.00pm Drinks/Nibbles for Austraclear/FMOA members operations and settlement staff at the same venue

Welcome to the first FMOA newsletter of 2005 and my first as chairperson. The association considers issues of markets, people and change. I am looking forward to the challenges that this role has in store for me. I am undertaking this role with some trepidation given the excellent leadership from Peter Thomas over the past nine years and I am sure all our members join the committee in thanking Peter for his commitment and endeavours.

The vision of the FMOA committee is to achieve a cross sector industry forum in New Zealand financial markets. We see the group as being co-operative and collaborative providing enrichment to industry participants through the sharing of information.

Key benefits from participation are:

- Enabling co-operation and cross pollination
- Networking
- Understanding the issues and proposed changes facing the local market including at the operational coal face
- Appreciation for regional and global activity
- An opportunity to contribute to the enhancement of interoperability and productivity for the New Zealand market.
- Awareness of issues that affect the New Zealand market

There is significant value in the collective market having regular contact through a forum. For too long in New Zealand the market has been fragmented within the industry and the FMOA gives the market an opportunity to come together.

Included in this newsletter is the agenda for the May conference which is being held in Auckland on 27th May. The presenters for this forthcoming conference have a strong focus on the ever changing Equities market in New Zealand with speakers from the Securities Industry Association and Inland Revenue Department, also presentations on the changes involved in the regulation of financial intermediaries. We will also hear about the challenges facing Auckland businesses.

There has been significant change in the New Zealand financial market since I joined a small broking firm in Wellington some twenty years ago. Mergers and acquisitions have seen a lot of the small brokers, both equities and fixed interest, either disappear or join with larger overseas names, even the major trading banks have been affected. Technology has changed significantly over the years with Swift messaging a prerequisite for banks and custodians. These technology changes are still continuing with the FMOA leading a working group to investigate the market requirements for a Central Securities Depository and the associated settlement system. There is more on this initiative in this newsletter.

Dealer accreditation and training has also become a hot topic and we will be working closely with major banks and with the Australian Financial Operations Association to develop training and accreditation programmes that can be used by all FMOA member firms. This topic becomes increasingly important with the regulatory changes that are being made in regards to Financial Advisors. Paul Chandler has assumed responsibility for this task and you can also find out more about this topic in this newsletter.

We will also be looking to increase our membership this year, making sure that the FMOA represents all financial organisations in New Zealand. So if you are reading this and you wish to contribute to NZ financial markets, contact Maria Chandler on email info@fmoa.org.nz. I look forward to seeing you all on the 27th of May and I hope that you will be able to join us for a drink at the close of the conference. Please make yourself known to the committee members, as these are the people you have chosen to represent your organisations.

Robert Poulter
FMOA Chairperson

CLS and the New Zealand Dollar

On 6 December 2004, the New Zealand dollar, together with the Korean Won, Hong Kong Dollar, and South African Rand, was added as an eligible settlement currency to the Continuous Linked Settlement (CLS) system.

CLS was developed as a market response to the risk that a participant in the foreign exchange market will lose the full principal amount of an FX transaction if the counterparty fails. This is because the seller irrevocably settles the sold currency but does not receive the purchased currency.

The failure of any FX counterparty can result in potential issues for the whole financial system as demonstrated by the failure of a small German bank, Bankhaus Herstatt (Herstatt), in 1974. When this bank failed several counterparties had irrevocably paid Deutschmarks to Herstatt against the expected receipt of USD, once the New York market opened.

Deutsche Bundesbank announced the closure of Herstatt at 10.30am New York time. Herstatt's USD correspondent bank immediately suspended all USD payments from the account leaving counterparties exposed to the value of the Deutschmarks that they had delivered. Hence FX settlement risk is also commonly referred to as Herstatt risk.

FX settlement risk is a concern to central banks because of the large settlement values involved. The April 2004 Bank for International Settlements survey of FX and derivatives market activity estimated daily global turnover in traditional fx markets of USD1.9trillion. In this survey, turnover in the New Zealand market was estimated to be on average about US\$7.5 billion per day.

CLS is a real-time system that enables simultaneous payment versus payment settlement of foreign exchange (FX) transactions in the live currencies. There are now 15 live CLS currencies – the four new currencies, together with the United States Dollar, Canadian Dollar, Swiss Franc, Euro, Japanese Yen, Australia Dollar, Singapore Dollar, Great British Pound, Swedish Krona, Norwegian Krone, Danish Krone. These settlements are completed irrespective of time zones and are final and irrevocable.

CLS Bank International (CLS Bank), a New York based bank holds accounts with the central banks of the 15 live currencies and provides multi-currency accounts for each of its settlement members. Settlement members are shareholders of CLS Services Limited, the holding company of the CLS Bank and must meet the criteria for settlement membership of CLS Bank.

CLS settlement is completed in a five hour window, although the currencies in the Asia-Pacific regions settle in a three hour window, starting at 0700 CET (5pm during the NZ winter and 7pm for most of the

NZ summer).

Up until 0630 CET settlement members can submit transactions for themselves and their customers. CLS settlement members are only required to fund their net short positions, in instalments spread over the CLS settlement window. These instalments are notified to settlement members in a final Pay-In schedule delivered to all settlement members at 0630CET. The CLS system settles gross or netted transactions, where netted transactions have been agreed bilaterally or multilaterally before being submitted to CLS.

CLS does not guarantee to settle every transaction. If any settlement member does not pay in all or some of their funding requirement some transactions will fail to settle and these unsettled transactions are returned to the relevant parties.

At 0700 settlement members pay in the net funds to the CLS Bank account held at relevant central banks – in New Zealand this is done using the SWIFT FIN Copy service known as SCP.

Payment and settlement run in parallel with CLS Bank settling transactions and paying out proceeds as they become available. Settlement can be completed before members have paid in all their funding. Before any transaction is settled the two members that are counterparties to the underlying transaction

must meet the following risk management tests:

- The debit balance in any individual currency must not exceed a set limit for the members – the Short Position Limit. A short position limit is set for each member in each currency.
- The total short position for all currencies, calculated as an equivalent USD value, must not exceed a set limit for the members - the Aggregate short position limits. An Aggregate short position limit is set for each member.
- The members must retain a Positive Account Balance, i.e. the overall balance of their multi-currency account with CLS is in credit.

Provided both members 'pass' these three tests then the Instructions will be settled simultaneously and the relevant currencies debited/credited to the Members' accounts in CLS Bank's books.

The primary requirements for CLS to be able to effect pay-outs to a Member are that the Member must not go in to a Negative Account Balance if CLS Bank were to pay-out funds and, CLS Bank must have the funds in their account with the relevant Central Bank. The pay-out algorithm is designed in order to give priority to the pay-out of Asia Pacific currencies.

“CLS is a real-time system that enables simultaneous payment”

CLS Bank in New Zealand has an account in the Exchange Settlement Accounting System (ESAS), and together with ESAS is a designated payment system under the Reserve Bank of New Zealand Amendment Act 2003. By being designated, under New Zealand law all payments made through it will be final and irrevocable. This means they cannot be unwound in the case of bankruptcy of one of the two parties, once the payment has settled.

During the first 3 months of CLS live operations the Reserve Bank implemented special measures for ESAS Accountholders, to deal with any potential liquidity shortages as a result of the dollar's entry to CLS. These facilities were withdrawn on 4 March 2005 and were:

- An increase in the use of FX swaps to inject liquidity into the system
- An increase in the bank paper used as collateral for ESAS intra-day reverse repurchases (Autorepos)
- An unsecured cash facility at a cost of 50 basis points above the OCR

I hope I speak for all local direct and indirect users of CLS by saying that the transition to the CLS world has been a good one, largely owing to the co-operative efforts of CLS Bank, the Reserve Bank and the local banking (and their parents) community. By working together we have ensured that the primary benefit of CLS – the reduction of FX settlement risk can be achieved for our financial system.

Useful websites:

- www.cls-services.com
- www.bis.org
- www.rbnz.govt.nz
- www.newyorkfed.org

by Debbie Hughes



Settlement Systems Working Group

Recently the FMOA formed a working group consisting of interested Austraclear members to look at the current Central Securities Depository structure and the associated settlement system (Austraclear). This group has been formed on the back of comments made by the Reserve Bank that they would be prepared to step aside from these functions should a suitable replacement be found. This replacement would need to be acceptable to current Austraclear users and also the Reserve Bank.

Recently impetus has been placed on this group as

both the Austraclear and ESAS systems require upgrading to ensure continuity of support and performance. A decision needs to be made whether or not to proceed with the Austraclear upgrade by December 2005, with any replacement system being in place by 2007. The ESAS system is being treated separately and the upgrade will proceed. The Reserve Bank has advised that it estimates upgrade costs to be in the vicinity of \$2-3 million for each system, a total of \$4-6 million. It has been stressed that these are only ballpark figures at this stage

Given the substantial investment required from members the working group is investigating the alternatives available, which also includes the current structure. The primary focus of the group over the next few months will be:

- Investigate and document the requirements of the market for both a Central Securities Depository and a settlement system.
- Prepare a Request for Proposal, which can be given to any potential provider.

The group is in the process of hiring a project manager who will lead these initiatives with funding coming from the key participants of the working group. The timetable for this project is extremely tight given that we have eight months left in which to fully investigate all alternatives.

We have also written to the Reserve Bank requesting that they convey details of the forthcoming upgrade to each member firm. The details requested are as follows:

- Estimated upgrade costs for the ESAS system.
- Estimated upgrade costs for the current Austraclear system. Details of what the upgrade options of both systems will include for each application
- Details of proposed additional functionality to be included in the ESAS and Austraclear upgrades and cost thereof e.g. Swift interface. A definitive date at which members must commit to the proposed upgrade of Austraclear.
- The expected lifespan of this each upgrade option

Members will be kept informed of progress via regular newsletters, but if you have any further questions please do not hesitate to contact Robert Poulter at [HYPERLINK](#)
Email: Robert_poulter@bnz.co.nz

“Austraclear and ESAS systems require upgrading to ensure continuity”

Learning to Reduce Risk

Proficio (Andrew Bell Managing Director)

No financial markets transaction can take place without the operations professionals. They provide a vital service to the trading floor by ensuring that all funds flow in a timely and correct manner and all the necessary documentation is completed. Considerable time is spent training staff on the systems and procedures specifically relating to their daily tasks, but, in many cases, the development of knowledge of the underlying instruments involved in the financial markets is overlooked. Whilst operational errors can have large financial consequences it is doubtful that they can be as large, and public, as the losses generated through trading room manipulation of market practices or product processes. An operations' professional that has an understanding of the product profile for which they are responsible is a valuable deterrent to unprofessional behaviour; they are a larger part of the risk management process.

Within New Zealand there is growing regulatory concern over the lack of certification of many participants in the financial markets. Internationally the process of regulated competence testing and accreditation is extremely well established. In our region financial markets operation professionals in Australia, Singapore, Tokyo and Hong Kong already undertake training to meet self-regulated or prescribed standards. Much of the content of their local programmes is modelled on the ACI Settlements Certificate. The mapping of local market training to a global programme creates portability for successful participants, and an international standard for business reference. ACI's education programme sets out the syllabi in three subject areas that test skills, knowledge and the understanding of wholesale financial market products, the market environment and professional behaviour.

“Within New Zealand there is growing regulatory concern”

How can you begin to broaden the training and development for yourself, or your organisation? Intuition Publishing is one the world's leading providers of online financial markets training. Specifically, Intuition offer online training that will allow candidates to study towards such things as ACI Settlements certification in their own time. In total over 180 tutorials covering over 200 hours of learning are available covering the broadest spectrum of financial markets products and skills. However, E-learning does not suit everybody, and that is how Proficio can assist in New Zealand. Proficio develop Integrated Learning Solutions

that build on Intuition's expertise by providing coaching, directed study or mentoring services for individuals or groups.

Proficio also work with Intuition to help build local tutorials for the online

programme, whether industry or company specific. Online hosting of learning records for individuals then provides verifiable training which may ultimately satisfy any regulatory requirement, perhaps under a future 'enforceable code of practice'.

For further reading on the area of Professional Vocational Development for Financial Markets Operations members we suggest you review these websites:

http://www.aciforex/education/back_office.htm

<http://www.intuitionknowhow.com>

<http://www.proficio.co.nz>

Or contact Andrew Bell at Proficio anytime on + 64 (0) 21 380 613

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