



Capital Markets Infrastructure Risk Ratings - Asia Pacific

The capital markets landscape of the Asia Pacific region has seen several major changes in the last few years. Asian exchanges have joined the global trend of consolidation prompted perhaps by potential and real competition from new market operators, the aspiration to maintain market status, augment visibility and source additional liquidity. Many exchanges in the region have signed memoranda of understanding with their peers, generally aimed at enhancing communication and cooperation and facilitating the exchange of information.

Consolidation of domestic exchanges has also taken place in a move to increase efficiency in the market and strengthen the positions of traditional national exchanges from future threats by alternative trading venues. The Jakarta Stock Exchange and Surabaya Stock Exchange merged to form the Indonesia Stock Exchange in 2007. The integration of the Osaka Securities Exchange (OSE) and the Jasdac Securities Exchange in Japan was completed in April 2010, with the OSE now operating the JASDAQ and NEO markets. Furthermore, the Tokyo Stock Exchange and the OSE are also considering a merger, slated for completion in Autumn 2012.

In the regional cross-border trading arena, the ASEAN (Association of South East Asian Nations) exchange inte-

gration has gathered new momentum. The target date for implementation of the ASEAN trading links is set for the second half of 2011 and will initially involve the Stock Exchange of Thailand, Bursa Malaysia and Singapore Exchange, with Philippine Stock Exchange joining in the first half of 2012. The relevant exchanges have completed the design study of the technology framework with NYSE Technologies. The realisation of this trading link will facilitate cross-border trading, improve the visibility of the markets and increase liquidity.

Singapore Exchange (SGX) announced a merger proposal with the Australian Securities Exchange (ASX) in October 2010. SGX and ASX previously operated a bilateral trading link which was discontinued in September 2006 owing to weak market demand. The proposed merger promised to offer a larger trading venue in the Asia Pacific region and to boost trading on the SGX and ASX. The combined entity would operate under 'ASX-SGX Limited', with both exchanges maintaining existing brands as separate legal and locally-regulated entities. However, on 8 April Australia's Treasurer Wayne Swan officially blocked the proposed merger of the two exchanges on advice from the Foreign Investment Review Board that the proposed transaction was contrary to the national interest.

Consolidation in the post-trade environment has been comparably less active, although some tidying-up of domestic infrastructures has occurred. The Taiwan Securities Central Depository completed its merger with the Debt Instrument Depository and Clearing Corporation in March 2006 to create the Taiwan Depository and Clearing Corporation. This has presented operational and financial efficiencies to the entities involved and the market as a whole. However, the plan to consolidate the Taiwan Stock Exchange, GreTai Securities Market, Taiwan Futures Exchange and TDCC has stalled and is unlikely to progress in the near future.

In February 2010, the Thailand Securities Depository transferred its function as a clearing house and central counterparty for securities transactions to the Thailand Clearing House (TCH), resulting in TCH becoming the sole clearing house for both securities and derivatives markets in Thailand. This has streamlined the clearing and settlement process in the market, ringfenced the CCP risk from the CSD and allowed TSD to concentrate on its core depository service provision.

The Hong Kong Monetary Authority, together with a group of Asian central banks, CSDs and Euroclear, issued a white paper on a pan-Asian post-trade infrastructure for debt securities, which sets out the development blueprint for a common bond settlement platform model in Asia. A task force composed of the HKMA, Euroclear and Bank Negara Malaysia recognises that a gradual approach is needed to achieve this, considering the size of the bond market, cross-border activities and the varying financial, regulatory and currency regimes in the region. Albeit in its infancy, the potential impact of such common platform on the clearing and settlement landscape in the region will be sizeable. The pilot platform is expected to be released in the first half of 2011.

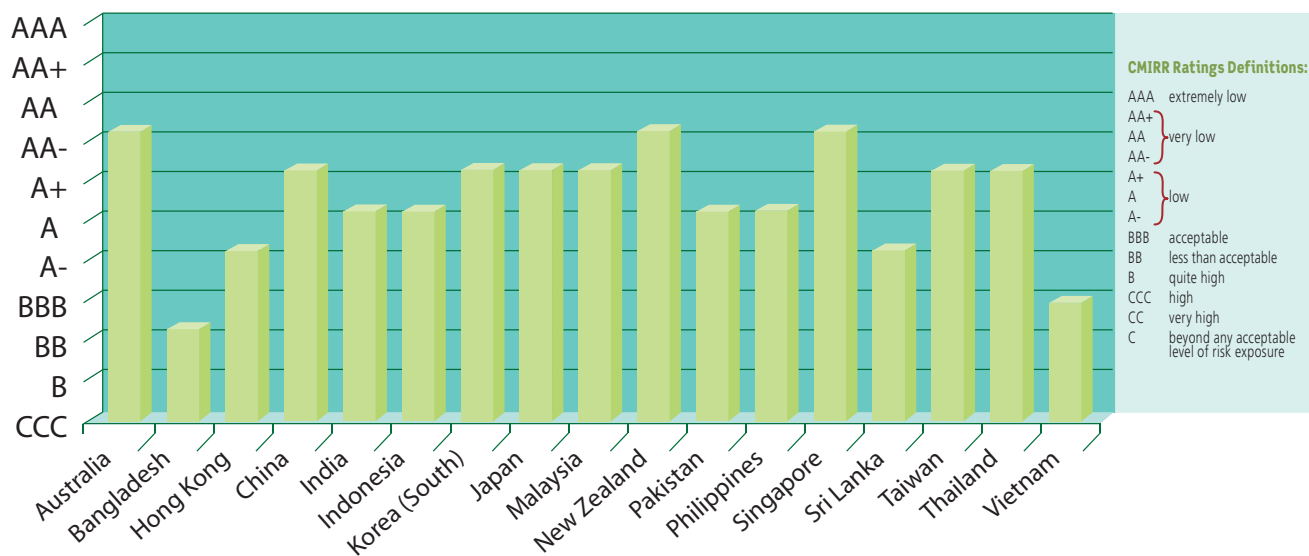
Bucking the trend of consolidation is New Zealand, where in September 2010 a new domestic settlement and clearing system was launched to rival the long-standing CSD services provided by the Reserve Bank of New Zealand. There are concerns around

the potential liquidity and operational inefficiencies this will bring to the market. To address these, the parent companies of both depositories have signed a memorandum of understanding on cooperation and responsibilities relating to clearing, settlement and depository services, highlighting an open market principle, the interoperability of the systems and competitive pricing.

Vietnam, a relatively young market, has made good progress in its trading and post-trade infrastructure. The Ho Chi Minh Stock Exchange is expected to join the ASEAN exchange integration project, albeit at a later stage. The Hanoi Stock Exchange has also signed a number of MOUs with exchanges in the region to further cooperation and exchange of information. The Vietnam Securities Depository switched to a new system in June 2010, simultaneously re-vamping the relevant operating procedures. This has resulted in the improved management of accounts at the VSD and better reconciliation with depository members.

In Mongolia, the Mongolian State Property Committee signed an exclusive Strategic Partnership Agreement with the London Stock Exchange in January 2011 to restructure and further develop the Mongolian Stock Exchange. There are 336 listed companies on the MSE with a market cap of approximately US\$2.78 billion as at February 2011, but the turnover is comparatively low. The MSE has signed several other MOUs (with the Tokyo Stock Exchange, Stock Exchange of Hong Kong, Singapore Exchange, MICEX) for further cooperation, exchange of information, joint projects and potential dual listing. How these agreements will affect the Mongolian capital market remains to be established. The Mongolian Securities Clearing House and Central Depository (MSCH&CD) provides clearing and settlement for securities trades in Mongolia. It has also signed an MOU with JASDEC, and the latter had reviewed the IT systems of MSCH&CD in 2010. JASDEC found the existing infrastructure to be sufficient for current market conditions, but it would need to be enhanced to accommodate increased volumes in the future. The MOU also provides for both depositories to meet

Fig 1: Thomas Murray Capital Markets Infrastructure Ratings



Source: Thomas Murray Ltd, London

on a regular basis to explore opportunities for improvement.

The smaller markets in Asia have recently been opening up to foreign investment. Laos established the Lao Securities Exchange in October 2010, with trading subsequently starting in January 2011. The LSX is jointly owned by the State of Laos (51 per cent) and the Korea Exchange (49 per cent), with the latter involved in providing training for the operators of the LSX, supervisory organisations and investors in Laos. LSX also signed a second MOU with the neighbouring Stock Exchange of Thailand (SET) for

the SET to continue supporting the development of the Lao capital market and for both exchanges to explore business opportunities. The LSX Securities Depository Centre provides clearing, settlement, depository and transfer agency services for LSX trades.

Cambodia, on the other hand, has delayed the opening of its first stock market. Originally planned for 2009, it has now been moved to later in 2011. KRX is also involved as part of a joint venture and will own 49 per cent of the new exchange, with the remainder being owned by the Cambodian government. ■

Thomas Murray Capital Markets Infrastructure Risk Ratings: Methodology

The overall rating is a weighted average of the different risk components including asset commitment risk, liquidity risk, counterparty risk, financial risk, operational risk and asset servicing risk. The CMIRR ratings are assigned to the market infrastructure as a whole and include components such as all CSDs in the market, arrangements for settlement of physical securities, payment systems, local regulations, etc.

The proprietary CMIRR ratings for the Asia Pacific region indicate that most markets (rated 'A' and above) have reasonable infrastructure and procedures to address risks in clearing and settlement, asset safety and asset servicing. Those with lower ratings are either still in the developing phase or in the process of adopting international standards. Participants in Bangladesh, for instance, experience increased counterparty risk exposure due to the absence of full

delivery-versus-payment practices. The pre-funding practice also extends asset commitment exposure. Vietnam, on the other hand, is continually developing its systems to further automate and eliminate manual processing. Nevertheless, the region collectively has taken positive steps to advance the clearing and settlement environment as evidenced by the number of best market practices that have been, and are being, considered for implementation.

Recent Market Developments

Australia: Chi-X Australia is awaiting the final decision on its application for a licence to operate a financial market. Once granted, Chi-X will become a direct competitor of the ASX.

China: The pilot test of margin trading and securities borrowing and lending was launched in March 2010. It is not clear whether non-resident investors are allowed to participate in this facility as yet, but a SBL facility should help mitigate fails by making securities available to cover short positions.

Hong Kong: HKEx is looking to list RMB-denominated products on the exchange this year and began testing with participants in late March 2011. The Central Clearing and Settlement System will undertake the settlement of these products, with no major technical adjustments to the system. HKEx also plans to implement T+2 finality arrangements for money settlement in CCASS from July 2011 to remove the overnight credit risk exposure and improve DVP arrangements.

Indonesia: The central counterparty for on-exchange trades, KPEI, implemented the continuous settlement system in August 2010, with the support of an intraday credit facility of IDR 1.79 trillion from four banks. Indonesia is also in the process of implementing the Single Investor ID, which will hopefully promote greater transparency and increase investor protection.

Japan: JASDEC completed 100 per cent dematerialisation of all listed domestic companies in January 2009. Furthermore, the depository is planning to adopt the ISO 20022 message format for the Pre-Settlement Matching System and Book-entry Transfer Systems.

India: The government continues in its drive to attract foreign investment into the country. In September 2010, the Ministry of Finance significantly increased foreign investment limits in government and corporate debt securities. Moreover, the working group on foreign investment in India has suggested rationalising foreign investment by introducing a single framework – the Qualified Foreign Investor framework – instead of the multiple existing arrangements for Foreign Institutional Investors, Non-Resident Indians, Foreign Venture Capital Investors, etc. The QFI framework is currently under consultation and its implementation would streamline the entry of foreign investors into the market.

Malaysia: Bursa Malaysia launched the e-Dividend payment service in April 2010, allowing it to pay cash dividend entitlements electronically to subscribing shareholders. The e-Share payment facility was also introduced later in 2010 to allow brokers to credit share sale proceeds directly into the selling client's bank account, and buyers to electronically pay brokers for share purchases. Funds can therefore be credited / debited on the same day, thereby cutting down the risks involved in cheque payments.

Philippines: The Securities Clearing Corporation of the Philippines has consulted with the market regarding enhancements to its risk management framework. It proposes to enforce margin requirements, a full netting mechanism and an earlier cash settlement option. These changes are aimed at further enhancing liquidity and participant default management. In June 2009, the Philippine Stock Exchange indicated its plans for the SCCP to provide depository functions. Considering that there is already a depository in existence, such a move could have ramifications for the operational efficiency of the market as a whole.

Sri Lanka: To reduce concentration exposure to one commercial settlement bank, the Colombo Stock Exchange adopted a multiple bank settlement model commencing October 2009. Although not quite the best option, multiple settlement banks spread the cash deposit risk and address the risks associated with the failure of a single settlement bank. The CSE is also working with the Central Depository on the introduction of a central counterparty for on-exchange trades.

Thailand: Thailand Securities Depository has postponed the launch of SWIFT messages for corporate actions notification to the third quarter of 2011 to allow adequate testing of the system with participants. Meanwhile, the supposed demutualisation of the Stock Exchange of Thailand was further postponed with the IPO estimated to be delayed to 2012.