

BOOK REVIEW

CLEARANCE AND SETTLEMENT SYSTEM IN THE WORLD SECURITIES MARKET: BY GROUP OF THIRTY, OF NEW YORK AND LONDON, COPY RIGHT, MARCH, 1989, GROUP OF THIRTY, NEW YORK/LONDON

The article focuses on the clearance and settlements system in the Worlds' Securities Markets and proffers recommendations aimed at facilitating securities trading internationally. It is the report of the study carried out by the Group of Thirty—a private sector group concerned with improving the working and efficiency of the international financial system especially the operation of the world securities market. Largely the outcome of a symposium organised by the group in March 1989, it discusses the state of clearance and settlement practices in the world's major securities markets. A well articulated document, put together by experts drawn from eight European countries, the piece reflect an indepth understanding of the risks and problems which confront participants in the Securities Market in the absence of an efficient clearing and settlement system.

The report is divided into two parts. Part 1 comprises the recommendations. Part II presents the working papers of the Working Committee.

There were nine recommendations which contained proposals about standards for clearance and settlement systems which should be set and maintained by national corporate securities markets, in order to improve efficiency and reduce risk and cost. The nine recommendations contained suggestions which relates to how risks associated with clearance and settlement systems could be reduced by shortening the time between trade date and settlements, thereby promoting trade guarantees. In maximising efficiency, the committee recommended that movement of physical certificates should be eliminated, while the use of netting system should be encouraged. Also, communications methods and settlement schedules should be standardised.

Part II formed the basis for the recommendations. This section which is set out in five chapters, dealt specifically with the various elements that comprise today's major world's securities markets. These include: Comparison systems (Matching), clearance and settlement system, Central Securities Depositories, Common Standards and Organisation and Governance. The working committee developed these working papers to serve as the background for their deliberations.

Chapter I emphasised the importance of establishing a timely, efficient and rigorous matching system. According to the article, matching system is a system whereby trades are compared to ensure that both sides of trade correspond. A universal adoption of this system, the authors opined, would enhance the exchange of securities and/or funds on settlement date and facilitate improved securities and money management, thereby reducing the risks of exposure and high failure rates experienced by many global investors. The types of comparison systems suggested include:

- (i) Two-sided system, which allows both parties to a trade (i.e. exchange and brokers/dealers to enter trade data). This is done with a guarantee arrangement in place. Parties to such trade usually agree to share the responsibility in case of default.
- (ii) Locked-in Trades. This is a system, whereby trades are compared at the time the transactions take place. Both parties to a trade agree that trade would be settled as recorded, unless both parties agree to cancel the transactions.
- (iii) One-sided system, which is used by market participants who choose not to join a two-sided comparison system.

Clearance and Settlement System is the focus of chapter II. A clearance system is designed to determine what counter-parties owe and what they are due to receive on settlement dates. In the clearance process, there is accountability, which allows funds and securities to change hands in an accurate and efficient way. Different types of Clearance System such as Trade-for Trade, Netting, Bilateral Netting, Daily Netting, Continuous Net Settlement (CNS) Rolling Settlement, Trade Guarantees, were discussed in details. In concluding the chapter, the authors agreed that the development of effective clearance and settlement systems is necessary for the successful implementation of a fast and reliable comparison system.

In chapter III, it was suggested that Central Securities Depository (CSD) should be used by all market participants in order to achieve an efficient and low-risk transactions. A Central Securities Depository would handle all types of securities, including foreign issues for any given market. The functions of a CSD include: the safekeeping of physical securities; the maintenance and operation of a computerised book entry security and cash delivery system (which may be linked to banks or other cash clearing systems on a daily basis); the maintenance of funds account for members; collection and distribution of dividends, interest and redemption of monies on securities holdings, on behalf of members; and the maintenance of relationships with CSDs in other markets.

Common standards is the focus of chapter IV. It was suggested that there should be common standards to communicate securities transactions in order to eliminate confusion, reduce risk associated with faulty communication, and facilitate efficient cross border trading. Some of the common standards developed by International Organisation for Standardisation (ISO) were discussed and their functions highlighted. It was recommended that all securities market should adopt the International Securities Identification Number (ISIN) to disseminate messages across the border, by using International Organisation for Standardisation. One major advantage perceived is that failure associated with poor or confusing communications would be removed, thereby promoting efficiency and encouraging faster and more accurate settlement in the securities market.

Chapter V discusses organisational structure and governance. The report discusses basic concepts, methodologies and systems relevant in trade processing. The discussions further elaborated on comparison systems, clearance systems and depositories earlier discussed in preceding chapters. It was agreed that whichever system was chosen, there must be some common standards and requirements concerning ownership, membership, governance and automation which would improve performance, maintain credibility and integrity of the

system and reduce risk. It was emphasised in the report that the activities of members in the securities market be monitored and restricted to ensure high standards, and operational skill. It was suggested that the data processing system of a clearing corporation/CSD must be designed, build and operated in a way that risk would be reduced to the barest minimum. It was emphasised that the comparison systems would need a highly automated data process equipment which would facilitate timely comparison and meet the demands of the market. Finally, it was suggested that a Central Securities Depository require a highly reliable, secure and sophisticated computer and data communications system, which can communicate through on-line terminal with its members and other institutions. The report however noted that international compatibility would need to evolve from local market and practices because each securities market has its own peculiarities, traditions and practices.

COMMENT

The efforts of the committee in studying the state of the clearance and settlement systems in the world's principal securities markets is commendable. The committee offers useful recommendations as to how risks associated with securities transactions can be reduced or eliminated. The study and the nine recommendations are expected to spur groups in the developing economies to undertake such studies and make recommendations that would help to improve the efficiency of their securities markets. However, the committee focused their attention mainly on ideal trading systems, without due cognizance of the trading systems of developing countries. Some of the terms used in the report are still novel to many stock market operators in the developing nations. Even for the Group of Thirty for which the recommendations were made, the timetable is rather tight for some of the countries within the Group to adhere to.

The systems of trading recommended in the report is such that would require sophisticated equipments and computer which may not be within the financial reach of most developing countries, thus, making the adoption of such system difficult in the short-run. Also lack of adequate infrastructure that could facilitate faster dissemination of information and promote greater integration between market operators and investors may stall progress. This does not imply that most developing countries, (Nigeria inclusive) have given up hope of modernising their securities markets system through the development of an effective securities clearance and settlements network.

In conclusion, the article charts the course for improving the efficiency of securities market operations world wide. But noting the relative smallness of the securities markets of the developing countries, it is highly unlikely that the Less Developed Countries (LDCs) can follow the trail blazed by the Group of Thirty. However the study and the recommendations which are well-written, provide a major goal that operators of securities market in LDCs should strive to accomplish in the not-so-distant future.

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