



# INSIDE CLEAR TALK

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1 - 3

- Hongkong Clearing consults market and investors
- Enhanced CCASS Terminal Project

4 - 5

- A very busy year lies ahead

6 - 7

- CCASS Statistics and Operations Highlights
- Quick Quiz

8 - 9

- Working Group on Corporate Communications to Launch Pilot Scheme
- Settlement Risk Reduced for Trades in Expiring Stocks
- Termination of CK Securities Co's participation in CCASS

10 - 11

- Clearing & Settlement of Debt Securities underway
- International Securities and Custody Services Forum
- Standard Chartered and Wing Hang joined as CCASS receiving banks
- Chief Executive Discusses RTGS with Stockbrokers

12

- CCASS Notice Board
- Custody & Settlement Asia '96
- Direct Stock Admissions

# **ClearTalk**

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## HONGKONG CLEARING CONSULTS MARKET AND INVESTORS ON INVESTOR PARTICIPATION

Hongkong Clearing will run a pilot test in late February in order to ensure the ECT terminal package (including terminal software, smart card and smart card reader) works well. Several participants will be selected to join the pilot test.

After the pilot test, Hongkong Clearing will review users' opinions and see if any modifications are needed. If no substantial adjustments are required, the project will be launched in late March as scheduled.

During the first installation period, 50 participants' offices will be installed with the ECT terminals. A circular will be issued inviting applications from participants in late March. Hongkong Clearing will speed up the installation process for remaining participants if necessary.

No special training is necessary for the operation of the ECT terminals.

The views of market practitioners and investors will be fully considered by Hongkong Clearing before the Company makes a decision on whether to implement direct investor participation in CCASS, said John Chan, chairman.

Mr Chan was speaking at a press conference on 2 January at which he released a consultation paper on a proposed working model for investor participation developed by Hongkong Clearing.

"The working model is designed to allow investors to open direct Investor Accounts in CCASS which will give them control over the movement of their shares deposited in CCASS; provide evidence of their shareholdings in CCASS; allow them to receive corporate information directly from listed issuers; and provide better legal protection of their interests in securities deposited in CCASS.

"Hongkong Clearing believes that allowing investors to open direct Investor Accounts in CCASS is the most desirable model for Hong Kong after studying



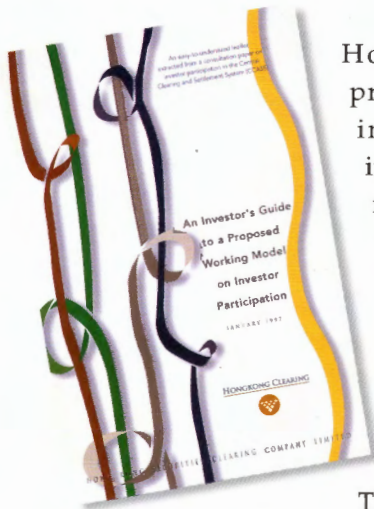
John Chan, chairman (centre), Stewart Shing, chief executive (left) and Betty Chan, assistant director of Corporate Communications, at a press conference announcing the consultation on investor participation.



**John Chan: The proposed model recognises the desire and need for investors to enjoy the benefits of a book-entry stock settlement system and to have control both legally and physically over their shares held in CCASS.**

the needs of investors and the various models adopted in other markets," Mr Chan said.

John Chan said a public consultation would be conducted in two stages over a three-month period. The first stage would involve distribution of the consultation paper to CCASS participants, listed companies and other market practitioners. "During the second stage, we will be consulting investors through a telephone and questionnaire survey conducted by an independent market research company."



Hongkong Clearing has prepared an explanatory information leaflet for investors on the proposed model which is available from brokers or custodians; or from Hongkong Clearing's service counters on the 2nd floor of Vicwood Plaza in Central.

The consultation of market practitioners is scheduled to end on 17 February and the survey of investors by mid-March.

## MAJOR FEATURES OF THE WORKING MODEL

The working model will provide investors with an additional method of safekeeping their shares.

It is proposed that individual and corporate investors be allowed to open stock accounts directly in CCASS and become Investor Account Holders. An Investor Account is in effect a depository account for share custody. Purchases and sales of stocks by Investor Account Holders and related settlements will still be handled through CCASS broker participants.

Investor Account Holders will each have a single CCASS stock account to record stock transactions; and will need to

designate a bank account to effect money transactions. They will be assigned individual identification account numbers and passwords to access CCASS.

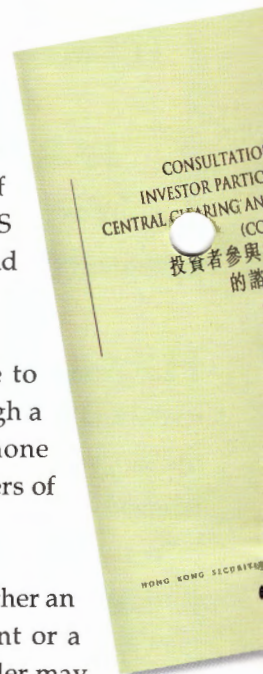
All stock transfer transactions by Investor Account Holders will be initiated by CCASS broker and custodian participants issuing SIs (Settlement Instructions). However, these need to be affirmed by the Investor Account Holders, before becoming effective.

Money settlement will be effected by Hongkong Clearing issuing electronic payment instructions to Investor Account Holders' designated bank accounts through the clearing system of the Hong Kong Interbank Clearing Limited.

Hongkong Clearing will mail daily activity statements and monthly statements to Investor Account Holders as evidence of their holdings of shares deposited in CCASS and as information about their accounts and money transactions.

Investor Account Holders will be able to communicate directly with CCASS through a self-service or operator-assisted telephone system, or in person at the service counters of the CCASS Depository.

Hongkong Clearing will not identify whether an Investor Account Holder is a cash client or a margin client. An Investor Account Holder may pledge his shares as collateral for loan or margin financing; and then transfer his shares in the CCASS stock account to the stock account of a CCASS broker or custodian participant who is providing him with the credit facility.



## IMPLICATIONS

### For brokers and custodians

The amount of manual work currently undertaken by brokers and custodians in handling deposits and withdrawals of

**Stewart Shing: The proposed model adopts a user-pay principle. The cost of the Investor Account service will depend on the activities of the individual investor, and the level of demand for the service.**



share certificates and nominee functions for their clients would be reduced or replaced by electronic entries in the form of SIs.

Both back-office operations and internal control systems of CCASS broker and custodian participants will need to be modified or upgraded to handle the new arrangements in transactions with Investor Account Holders.

#### For investors

The proposed model enables investors to enjoy the benefits of computerised book-entry settlement, which avoids the risk of loss of share certificates and eliminates the cost of registration of share transfers.

Investors will have to assume certain obligations and responsibilities. They will still have to manage the settlement risk with their brokers or custodians as settlements will continue to be handled through them.

#### For Hongkong Clearing

The admission of investors into CCASS represents the expansion of the scope of services of Hongkong Clearing from market intermediaries to investors. It is expected that immobilisation of share certificates will be increased and consequently the security risk of both loss of certificates in transit and forgery will

be minimised.

The service may have an adverse impact on the financial position of Hongkong Clearing if demand is less than anticipated.

## PARTICIPANT SEMINARS

To give CCASS participants a better understanding of the proposed working model, Hongkong Clearing organised three seminars for participants in January. About 300 representatives from participants attended the seminars.

Some of the commonly asked questions at the seminars:

Q1. How can a broker be sure that an Investor Account Holder has enough stock to fulfil a selling order given to the broker if the stock has not yet been transferred from the Investor Account to the broker's stock account? Is the broker allowed to check the stock balances of an Investor Account?

A1. Information on stock balances in Investor Accounts is

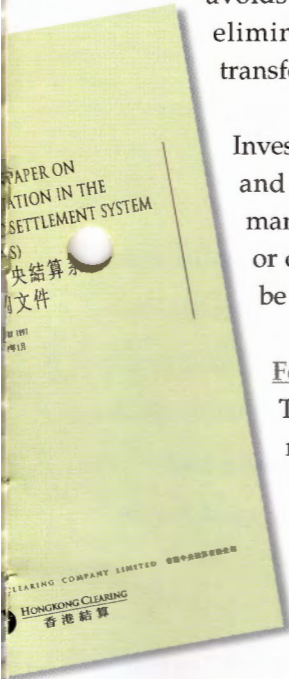
not available to brokers. A broker may arrange with an Investor Account Holder (his client) to transfer the stock from the Investor Account to his stock account prior to the execution of a selling order. Alternatively, a broker may request an Investor Account Holder to show him the CCASS statements.

Q2. Is an Investor Account Holder allowed to delegate his affirmation authority to more than one CCASS broker or custodian participant?

A2. Hongkong Clearing will consider whether to allow an Investor Account Holder to delegate his affirmation authority to more than one CCASS broker or custodian participant at the system design stage of the project.

Q3. If the defective securities deposited by an Investor Account Holder are later transferred to a CCASS participant's stock account for settlement purposes, will the CCASS participant be liable for the defective securities?

A3. As with the current practice, only the party who deposits the defective securities will be held liable. In this case, it is the Investor Account Holder.



A presentation of the proposed working model.

Kelvin Lee, director of Planning and Development and Kim Mok, director of Compliance answering questions raised by participants.



# A VERY BUSY

"All years are busy but 1997 is shaping up to be a very busy one," said Stewart Shing, chief executive.

Mr Shing told *Clear Talk* that the major project this year would be investor participation in CCASS. "We have already launched the first phase of the consultation into our proposed working model for investor participation; and have made a presentation to the Legislative Council's Panel on Financial Affairs," he said.

"Our meeting with the panel was useful as the members were generally supportive. Some members indicated that they would like to see investor participation introduced more quickly than we project," Mr Shing said.

The first phase of the consultation involving CCASS participants, banks and securities industry professionals is expected to be completed by 17 February. The second phase includes a telephone survey of investors, backed up by a questionnaire survey, and is expected to be completed by mid-March.

Mr Shing said recommendations for the system design were expected to be submitted to the Board of Directors for approval by the end of April. "On a conservative estimate, it should take 12 to 15 months to implement investor participation in CCASS once the system design basis has been accepted by the Board," he said.

Mr Shing stressed that no single project should be considered in isolation, or as being of over-riding importance. "All projects are important, and all contribute in their own way to achieving the Company's objectives," he said.

**All projects are important, and all contribute in their own way to achieving the Company's objectives**

"Our prime objectives are to reduce costs and risks and increase efficiency. We shall keep our tariff basis under constant review to help us to identify areas where we can reduce costs -- and I think we have a very good record in this respect.

"We have a number of specific projects designed to help us further reduce risk, one of which is the collection of intra-day marks. We have already begun producing an intra-day marks report to show our participants what is involved, and expect to introduce intra-day collection of marks within the next month or two. This will reduce market risk arising from intra-day price fluctuations."

Mr Shing said the Company was planning to expand the types of collateral it accepts. "Currently, we accept only cash or bank guarantees as collateral. We are considering also accepting stock as collateral, and this will require system changes.

"Other risk management measures on which we will be consulting our participants include those for handling trading or guarantee caps, special trades and notional balances on long positions."

# YEAR LIES AHEAD

Mr Shing said efficiency would be increased through introduction of ECT, Enhanced CCASS Terminals. "ECT will be introduced on a test basis with selected participants during the first quarter of the year; and extended to all participants in due course.

"We have already started as a pilot scheme, supplying participants with corporate communications for segregated account holders, following analysis of the submissions received in response to last year's consultation on corporate communications. Further development of this service will take place during the year.

"CCASS is ready to start clearing debt securities and we are in discussion with an issuer over admission to CCASS of its new issue. Since the beginning of the year, we have been clearing expiring warrants by CNS (Continuous Net Settlement) rather than IT (Isolated Trades); and in the second quarter, we will arrange for the Stock Exchange Options Clearing House to use CNS rather than IT for exercised warrants. This will reduce settlement failures and increase efficiency.

"During the year, we will be re-examining the need for us to offer a centralised stock borrowing and lending service. There was little enthusiasm for this service when we consulted the market in late 1995. However, circumstances may have changed as a result of expanded short selling on the Stock Exchange and the growth of the derivatives market, including equity options.

"On the hardware side, we are merging the production and development environments of our mainframe computers. This will reduce the cost of software maintenance and increase efficiency through greater flexibility.

"At the moment, we are preparing to offer services in response to new market development projects of the Stock Exchange, in particular the trading of global derivative warrants. This will require major changes to CCASS, which will have to be converted from a single currency to a multiple currency system."

**... the Company would be able to meet current and future challenges.**

Mr Shing said he was confident that the Company would be able to meet current and future challenges. "Our technical systems are stable and based on solid foundations, and their flexibility allows for systems enhancement and expansion," he said.

"Staff turnover is considered to be low, especially at senior levels. This means that there is in-built continuity and a strong spirit of teamwork. Above all, the broadly based Board of Directors gives valuable advice and strong support to the executive management of the Company for the successful completion of projects.

"I am confident that Hongkong Clearing is well placed to meet any challenges that lie ahead," Mr Shing said.

# CCASS STATISTICS

The market remained active during the two months of October and November 1996. Hang Seng Index climbed further during these two months and closed at 13,393.

## Exchange Trades

In October, an average of 65,244 trades were processed daily in CCASS, involving 3.65 billion shares valuing \$7.0 billion. The daily average of Exchange trades increased to 83,683 in November, involving 4.13 billion shares valued at \$9.4 billion.

During these two months, CCASS processed 99.96 per cent of Exchange trades daily.

## Netting Efficiency of CNS Trades

A daily average of 63,783 trades with a total value of \$6.36 billion went through CCASS for Continuous Net Settlement (CNS) in October. An average of 127,566 novated contracts was created daily and netted to 28,218 CNS positions, leaving 22.20 per cent of novated contracts for settlement.

In November, the daily average number of trades went through CCASS for CNS rose to 81,832 at a value of \$8.55 billion. An average of 163,664 novated contracts were created daily and netted to 33,938 CNS positions, leaving 20.89 per cent for settlement.

In October, novated contracts generated a daily average of \$13 billion in money obligations which were netted to \$3.3 billion. The daily money obligations generated from novated contracts in November was \$17 billion and were netted to \$3.9 billion. The daily average funds netting efficiency for October and November were 73.95 and 77.30 per cent respectively.

## Settlement Efficiency of CNS Stock Positions

The daily average settlement efficiency rate of CNS

stock positions for October was 95.69 per cent on the due day and 99.83 per cent on the settlement day following the due day. The figures for November were 95.68 per cent and 99.83 per cent.

## Settlement Instructions (SIs)

In October, an average of 18,235 SIs were settled daily in CCASS, involving 4.50 billion shares with a market value of \$18.10 billion.

The average number of SIs settled daily in CCASS in November was increased to 22,180 which involve 4.42 billion shares valued at \$22.44 billion.

## Depository Transactions

In October, the CCASS Depository handled an average of 1,825 deposit/withdrawal transactions per business day, and processed 53,000 share certificates a day. The corresponding figures were 2,074 transactions involving 46,000 share certificates per business day in November.

As at the end of November, 898 stocks had been admitted into CCASS for clearing and settlement. About 214 billion shares were under the custody of the CCASS Depository, representing 44.49 per cent of the total issued share capital of the admitted stocks. The total market value of the shares was \$1,042 billion, representing 29.82 per cent of the total market capitalisation of the admitted shares.

## Participants

At the end of November, there were 554 CCASS participants including 486 broker participants, 63 custodian participants, four stock pledgee participants, and one clearing agency participant.

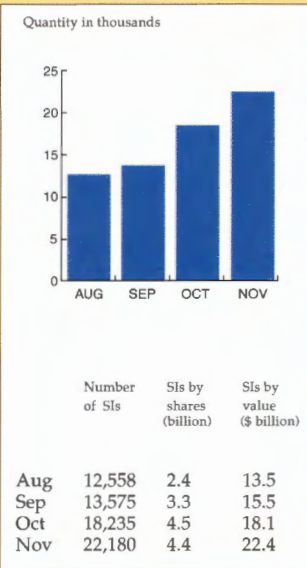


# OPERATIONS HIGHLIGHTS (AUG - NOV 1996)

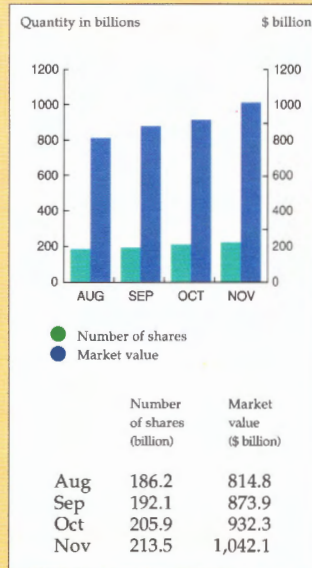
Average daily Stock Exchange trades processed in CCASS  
(including CNS trades, isolated trades and cross trades)



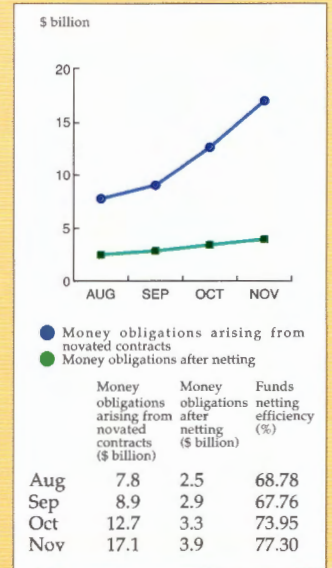
Average daily Settlement Instructions (SIs) settled in CCASS  
(both receiving and delivering SIs are counted)



Securities under CCASS custody  
(balances at the end of each month)



Average daily funds netting efficiency under CNS



## Quick Quiz

1. How many Batch-settlement-runs are there on every settlement day?

2. What is the Formula for Accrued Interest Calculation which appears in the Provisional Clearing Statement and Final Clearing Statement used for ?

3. How many User Groups have been defined by Hongkong Clearing?

Answers on page 12.

## WORKING GROUP ON CORPORATE COMMUNICATIONS TO LAUNCH PILOT SCHEME

The Working Group on Corporate Communications has begun a pilot scheme to test the workflow and the response of investors to the Corporate Communications Project which aims to improve the flow of corporate information between listed issuers and non-registered owners of securities held in CCASS.

Presently, if investors entrust their securities to their brokers or custodians for custody, the intermediaries can either register the securities in their own names (or in the name of their nominees), or keep the securities in the CCASS Depository. Securities deposited into the CCASS Depository will be registered in the name of HKSCC Nominees Limited, and the owners of the securities will no longer be registered shareholders. These investors rely on their intermediaries to forward corporate communications to them.

The target group to receive corporate documents will be CCASS segregated account statement recipients who have given written authorisation through CCASS participants to Hongkong Clearing to give their names and addresses to company registrars.

On an event driven basis, Hongkong Clearing will extract statement recipients' information for forwarding to the registrars who, on a best effort basis will include them in their mailing list for corporate communications. However, segregated account statement recipients will still need to submit their responses to corporate actions through their brokers or custodians.

With regard to the long term implementation, the Working Group is making modifications to the model based on the feedback to the consultation paper. Hongkong Clearing is discussing with the software vendor of the BOS system commonly used by most participants, to establish enhancement requirements.

# SETTLEMENT RISK REDUCED FOR TRADES IN EXPIRING STOCKS

Since 9 January 1997, Hongkong Clearing has allowed Exchange trades in expiring CCASS eligible stocks, mostly warrants, to be settled under Continuous Net Settlement (CNS).

Kim Mok, director of Compliance said: "Under the new arrangement, expiring stocks can continue to be traded by automatching. Broker participants' settlement risk in trading expiring CCASS eligible stocks is greatly reduced as trades settled under CNS are guaranteed by Hongkong Clearing."

To ensure that broker participants can settle short CNS positions in expiring stocks on the due settlement date under the new arrangement, Hongkong Clearing may require broker participants to provide evidence of shareholdings to support their short positions in expiring stocks.

If a broker participant with short CNS positions fails to provide acceptable evidence, Hongkong Clearing may direct the participant to execute an immediate buy-in to cover the short position.

Hongkong Clearing may also isolate an Exchange trade for risk management purposes.

If a defaulting participant fails to deliver shares to cover a CNS position and the shares are not freely available in the market, Hongkong Clearing may pay money compensation to the receiving broker participant.

For details of the new arrangement, please refer to Hongkong Clearing's circular dated 16 December 1996, circular number 277/96.

## TERMINATION OF C. K. SECURITIES CO'S PARTICIPATION IN CCASS

C. K. Securities Company's participation in CCASS was terminated by Hongkong Clearing on 15 November 1996 following the High Court's order to appoint administrators to take all necessary actions to protect the interests of the clients of C. K. Securities Company, including preservation of property and returning securities to identifiable owners. C. K. Securities Company's access to CCASS functions had been suppressed from 16 October 1996 after a restriction notice was issued by the Securities and Futures Commission to prohibit that company from disposing of its assets without the Commission's prior written consent.

# CLEARING & SETTLEMENT OF DEBT SECURITIES UNDERWAY



An enhanced CCASS system is in place to help implement the clearing and settlement of debt securities as of 9 December 1996.

Initially, Exchange trades in debt securities will be settled under the Isolated Trades system. The Company will consider the settlement of trades under Continuous Net Settlement when participants become acquainted with the operation and the volume of trades increases.

Accrued interest for interest bearing debt securities will be calculated by the system and settled with corresponding trades. Information on the interest amount will be available on reports to participants and through on-line functions.

Provision of common nominee services for debt securities includes collection and distribution of interest; exercise of

convertible bonds for underlying securities; and redemption in part or full.

The admission procedures and fee structure for debt securities are similar to other securities admitted to CCASS, with minor variations in the calculation basis for particular fee types. Details were released in December to all participants. The revised Terminal User Guide containing the detailed description of reports and on-line functions related to the enhanced features, is available for collection at the service counters on the 2nd floor of Vicwood Plaza in Central.

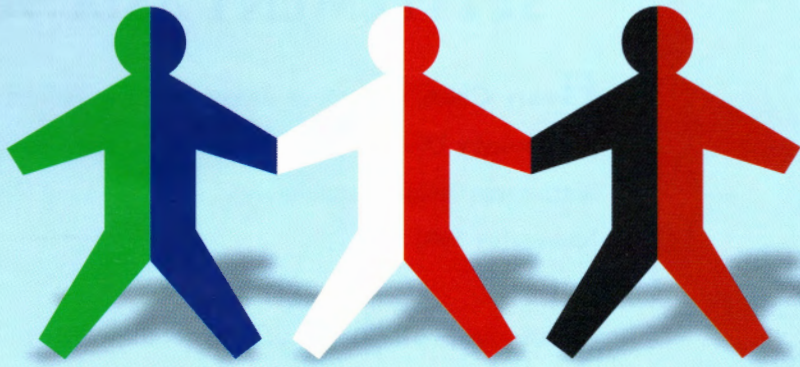
The printed version of the amendments to CCASS Rules and Operational Procedures regarding newly added functionalities of the enhanced CCASS system will be available in February.

## INTERNATIONAL SECURITIES AND CUSTODY SERVICES FORUM

Hongkong Clearing participated in the International Securities and Custody Services Forum held recently in Frankfurt. The three-day forum, organised by the Deutsche Bank Group, also included an exhibition and workshops on regional developments and topical issues on securities services. Ten central depositories, including Hongkong Clearing, took part in the Forum attended by over 200 international institutional investors.

Picture shows Hongkong Clearing's booth at the exhibition.





## STANDARD CHARTERED AND WING HANG JOINED HONGKONGBANK AS RECEIVING BANKS FOR CASH PREPAYMENTS

Standard Chartered Bank and Wing Hang Bank became CCASS receiving banks on 9 December 1996 and 24 January 1997 respectively.

Joining as a receiving bank helps the bank to arrange CCASS broker participants' requirements for cash prepayments under RTGS (Real Time Gross Settlement) which serves to transfer funds instantly.

Receiving banks provide electronic banking services and services for the clearing of CHATS (Clearing House Automated Transfer System) payments made by CCASS broker participants.

If a CCASS broker participant requires early release of shares allocated under CNS (Continuous Net Settlement), the participant has to make cash prepayment through CHATS to the receiving banks of Hongkong Clearing. The major criteria of becoming a receiving bank are to have a substantial number of CCASS broker participants as clients; and to be able to provide an electronic banking terminal to communicate with Hongkong Clearing for instant monitoring of incoming funds and actions.

## CHIEF EXECUTIVE DISCUSSES RTGS WITH STOCKBROKERS

Stewart Shing, chief executive, spoke on 'The Impact of RTGS on CCASS Broker Participants' at a Hong Kong Stockbrokers Association's luncheon seminar on 5 December 1996 shortly before the launch of RTGS (Real Time Gross Settlement) by the Hong Kong Interbank Clearing Limited.

Mr Shing compared the interbank clearing system's interface with CCASS before and after the launch of RTGS. He also discussed the impact of RTGS on Hongkong Clearing and CCASS broker participants.

Picture shows Stewart Shing (second from left), chief executive chats with Cheung Tin Sang (right), chairman of the Hong Kong Stockbrokers Association and other members of the Association before the luncheon.



## CCASS NOTICE BOARD

### RECORD HIGH TRADES IN JANUARY

The number of trades processed in CCASS reached new highs during the past two months, hitting a new record on 7 January when 122,513 trades were processed. The previous highest number of trades for a single day was 111,253 trades on 4 January 1994.

The record for the highest number of trades for a month was made in November 1996 (21 trading days) when 1,757,346 trades were recorded while in December 1996 (20 trading days) had 1,460,625 trades.

## CUSTODY & SETTLEMENT ASIA '96

Henry Chan, executive director of the Information Technology Division, was a speaker at the Custody & Settlement Asia '96 conference, held in Hong Kong in November 1996.

Picture shows Mr Chan explaining Hongkong Clearing's latest technological developments including, the enhanced CCASS terminal project at the conference.



## DIRECT STOCK ADMISSIONS

During the two months of November and December 1996, a total of 99 eligible new issues were admitted to CCASS of which 18 issues adopted Jumbo Certificate arrangement.

	Ordinary Shares	Registered Warrants	Rights	Total
Eligible new issues listed on the Stock Exchange and admitted to CCASS	20	70	9	99
Issues adopted Jumbo Certificate arrangement	16	2	N/A	18

## Quick Quiz

- There are three Batch-settlement-runs carried out on every settlement day, at 12:00 noon, 2:30 pm and 3:45 pm.
- The Formula for Accrued Interest Calculation is used for the calculation of the accrued interest of a trade in an interest-bearing
- debt security. The inclusion of this new item is related to our plan to admit interest-bearing debt securities.
- Seven. They are Group A, C, D, E, F, G and H. Each User Group can access a different set of CCASS functions. This helps participants to strengthen their internal controls.