



U. S. Securities and Exchange Commission
Washington, D. C. 20549 (202) 272-2650

**News
Release**

**Remarks on the Group of Thirty Report
on International Clearance and Settlement**

David S. Ruder
Chairman
United States Securities and Exchange Commission

New York City
May 15, 1989

The views expressed herein are those of Chairman Ruder and do not necessarily reflect those of the Commission, other Commissioners, or the staff.

REMARKS ON THE GROUP OF THIRTY REPORT
ON INTERNATIONAL CLEARANCE AND SETTLEMENT

I. Introduction

The Group of Thirty has made an extremely important contribution to the world's financial markets by preparing the report entitled "Clearance and Settlement Systems in the World's Securities Markets." As noted in the foreword to the report, all too commonly, market participants have neglected international clearance and settlement, assuming it is a matter for technical experts only. The fact that a private sector group made up of high level international businesspeople, bankers, and others has treated clearance and settlement as an area requiring immediate attention emphasizes its importance. The report should spur all market participants to consider the changes needed to ensure that clearance and settlement systems are capable of supporting worldwide securities trading safely and efficiently.

The Group of Thirty's list of recommendations covers the basic ingredients for efficiency -- centralization, automation, early comparison and settlement, broad participation that includes institutional investors, trade netting, book-entry deliveries, and standard identification systems. Some of the recommendations also address risk and safety, such as the use of delivery versus payment to settle securities transactions, and same day funds settlement. The greatest benefit of this list of recommendations, however, may be its status as a blueprint for all markets wishing to attract or maintain cross-border securities trading. The blueprint serves as a clearly defined,

uniform set of procedures for all participants. It will establish a basis for freer competition among markets, facilitate the movement of capital across those markets, and enhance investor confidence in those markets. The report may be the most important document to date on the subject of international clearance and settlement, and it will have a strong impact on the future of international securities trading.

II. The Recommendations

The Group of Thirty is a private sector group of international businesspeople, bankers, and others concerned with the international financial system. In March 1988, the Group of Thirty held a symposium ^{1/} to discuss the state of clearance and settlement practices in the world's principal markets and the plans in individual countries for making those practices more compatible. Symposium participants concluded that agreement on a set of practices and standards that could be embraced by each of the many world markets was highly desirable. The Group of Thirty created a Steering Committee to look into this matter. The Steering Committee in turn appointed an international Working Committee of experts from banks, broker-dealers, clearing organizations, and exchanges to formulate a set of specific recommendations for consideration. Those recommendations form the basis of the Group of Thirty's report, and are set out below.

^{1/} The symposium took place in London, England on March 9, 1988, under the leadership of Lord Richardson, former Governor of the Bank of England. I was one of the participants presenting views on international clearance and settlement problems.

1. By 1990, all comparisons of trades between direct market participants (i.e., brokers, broker-dealers, and other exchange members) should be accomplished by T+1.

2. Indirect market participants (such as institutional investors, or any trading counterparties which are not broker-dealers) should, by 1992, be members of a trade comparison system which achieves positive affirmation of trade details.

3. Each country should have an effective and fully developed central securities depository, organized and managed to encourage the broadest possible industry participation (directly and indirectly), in place by 1992.

4. Each country should study its market volumes and participation to determine whether a trade netting system would be beneficial in terms of reducing risk and promoting efficiency. If a netting system would be appropriate, it should be implemented by 1992.

5. Delivery versus payment (DVP) should be employed as the method for settling all securities transactions. A DVP system should be in place by 1992.

6. Payments associated with the settlement of securities transactions and the administration of securities portfolios should be made consistent across all instruments and markets by adopting the "same day" funds convention.

7. A "rolling settlement" system should be adopted by all markets. Final settlement should occur on T+3 by 1992. As an interim target, final settlement should occur on T+5 by 1990 at the latest, save only where it hinders the achievement of T+3 by 1992.

8. Securities lending and borrowing should be encouraged as a method of expediting the settlement of securities transactions. Existing regulatory and taxation barriers that inhibit the practice of lending securities should be removed by 1990.

9. Each country should adopt the standard for securities messages developed by the International Organization for Standardization (ISO Standard 7775). In particular, countries should adopt the ISIN numbering system for securities issues as defined in the ISO Standard 6166, at least for cross border transactions. These standards should be universally applied by 1992.

III. Some Prior Views

The recommendations in the report are consistent with the views of the Securities and Exchange Commission. In its November 1988 Policy Statement, "Regulation of International Securities Markets," the Commission stated that one of the most important goals in achieving a global securities market will be to establish efficient, comparable, and automated national and international clearance, settlement, and payments systems. ^{2/} The Commission cited the current wide-ranging differences in dealer and institutional comparison periods, settlement periods, and degrees of automation as examples of problem areas. The Commission also called for all systems to permit book-entry movement of securities. The policy statement noted that the current lack of coordination in clearance, settlement, and payments systems increases the costs and risks of global securities trading. In the Commission's view, a top priority for all markets is centralized depository and clearing systems with worldwide standards for these entities.

Efficiency in clearance and settlement is also important as a means of reducing uncertainty in times of market stress, such as October 1987. In October 1988, I presented a paper focusing on the future of the U.S. securities markets after the October 1987 market break, and I identified clearance and settlement as

^{2/} Policy Statement of the U.S. Securities and Exchange Commission, "Regulation of the International Securities Markets" (November 1988). See Release No. 33-6807 (November 14, 1988), 53 FR 46963 (November 21, 1988).

one of five areas requiring close attention. 3/ In volatile market conditions, uncertainty during the comparison period about precise settlement risk can reduce a firm's willingness to commit capital. A reduced comparison period should lead to more certainty about firm obligations and should improve capital flow during severe market conditions. Other steps such as clarification of payment obligations with clearing banks also should reduce the stress placed on clearance, settlement, and payments systems during severe market conditions. In general, clear rules, well understood by all parties, should enable the securities markets to operate more efficiently under normal market conditions as well as during times of massive volume and market movements.

Clearance and settlement issues also were considered by the Working Group on Financial Markets following October 1987. The Working Group consists of officials from the Federal Reserve Board, the Department of the Treasury, the Commodity Futures Trading Commission, and the Securities and Exchange Commission. The Working Group reviewed existing clearing and payments systems to identify and set priorities for actions that could be taken to reduce uncertainty, increase coordination, assure confidence in the integrity of such systems, and facilitate their smooth operation in volatile markets. In its Interim Report, the

3/ Chairman D. Ruder, "October Recollections: The Future of the U.S. Securities Markets," Presented at The Economics Club of Chicago (October 20, 1988) (available from the Securities and Exchange Commission).

Working Group encouraged system refinements geared toward consistent understanding about the obligations of all parties, and initiatives such as cross-margining and coordinated settlements among markets that could reduce system risks and payments. 4/

IV. Reactions to the Recommendations

The recommendations in the Group of Thirty report merit serious consideration and provoke some thoughts on the future. Significantly, the U.S. securities markets currently conform to, or are moving toward substantial conformity with, most of the Group of Thirty's recommendations. Central depositories permitting book-entry delivery, institutional participation in confirmation and affirmation systems, trade netting, delivery versus payment, rolling settlements, and securities lending to support settlement -- all are firmly established in the U.S. securities markets.

A. Earlier Trade Comparison

Substantive progress toward earlier trade comparison is being accomplished in the United States through the efforts of the New York Stock Exchange, National Association of Securities Dealers, National Securities Clearing Corporation, and other self-regulatory organizations. I understand that within nine to twelve months, a period that meets the report's target date for this recommendation, the substantial majority of inter-dealer

4/ Working Group on Financial Markets, "Interim Report" (May 1988) (submitted to the President of the United States).

transactions in over-the-counter, NASDAQ, New York Stock Exchange, and American Stock Exchange securities will be compared on the same day or on a next day basis, that is, at least by "T+1."

B. Earlier Trade Settlement

As you know, earlier trade comparison will mean that the clearing agency guarantees of trade settlement will occur earlier, and that clearing agencies would then be exposed to market risk for a longer period of time. For this reason, earlier trade comparison necessarily will bring about the need for earlier settlement or other means, such as marks to the market or higher clearing fund contributions, to protect the clearing agencies from market exposure over the more extended time period. The question of earlier settlement, therefore, already has been under active consideration in the context of domestic clearance and settlement without regard to the question of uniformity in cross-border transactions. Its presence on the Group of Thirty's list of recommendations makes serious discussion of the issue even more timely and important.

C. Standardized Identification Numbering Systems

The question of standardized identification numbering systems also is under discussion among securities professionals in the United States. By recommending use of the International Securities Identification Number, or "ISIN," but limiting the recommendation to cross-border trades, the recommendation on numbering systems acknowledges that substantial investment has

been made in the infrastructure of domestic systems. This investment would be preserved, since domestic clearance and settlement systems would be free to continue use of their current identification numbering systems, such as CUSIP in the United States, ^{5/} as long as means exist to convert easily to ISIN for cross-border trades. Nevertheless, an interim solution such as a conversion facility should not preclude discussion of whether outright adoption of ISIN is the best longer-term solution to the problem of inconsistent securities identification numbering systems.

D. Same Day Funds Settlement

The area where U.S. securities markets are most clearly lacking conformity with the recommendations is in the same day funds settlement area. This recommendation could not be implemented immediately and requires further study and discussion. Although market participants generally agree that conversion to same day funds settlement would create long-term advantages and efficiencies, the recommendation raises several significant concerns. First, concern exists about the present ability of the Fedwire system and other electronic funds transfer systems to handle an increased volume of large dollar transactions late in the day. Second, some believe that retail customers will resist paying for their securities on an accelerated basis. Third, a switch to same day funds settlement,

^{5/} CUSIP has been developing an international system, called CUSIP International Numbering System, or "CINS," for use in identifying non-U.S. securities in domestic systems.

at least during the transition period, will reduce the cash available to some banks and brokers. Fourth, same day funds settlement will reduce the amount of time clearing agencies and their participants have to resolve temporary liquidity problems, thus increasing the need for clearing agency monitoring of clearing member financial condition. We should begin a discussion of these concerns and all aspects of same day funds settlement immediately, and should be careful to include all affected parties in discussions of this issue.

V. Clearing and Depository Linkages

Market participants generally have concluded that one central clearing entity for all international equity transactions is not feasible in the short run. Thus, the best hope for international clearance and settlement lies in safe and efficient linkages between centralized clearing and depository entities in each market. In this connection, last week, the Commission approved the application of International Securities Clearing Corporation, or "ISCC," to become a registered clearing agency. ^{6/} ISCC was founded with the intention of forming linkages with clearance and settlement entities abroad. As you know, ISCC has been operating various linkages under the terms of

^{6/} Securities Exchange Act Release No. 26812 (May 12, 1989). Consistent with the Commission's historical treatment of clearing agency applications, the registration is temporary, and is effective for a period of eighteen months. At the end of the eighteen-month period, the Commission will review ISCC's operations and may vote to approve the application indefinitely, to extend the temporary registration, or to deny registration.

no-action letters issued by the Commission's Division of Market Regulation. We expect that ISCC will play a significant role in monitoring efforts to implement the Group of Thirty recommendations both within the United States and in those countries where it has formed or intends to form linkages with local clearing entities.

In its November 1988 Policy Statement, the Commission noted that sound linkages require that adequate safeguards exist to reduce the risk of default and to contain losses in the event of a default. The list of recommendations in the Group of Thirty's report covers the necessary ingredients for safe, efficient clearance and settlement systems. Implementation of this list of recommendations by all markets will take us far toward safe and efficient clearing linkages that will support increased international securities trading. Moreover, agreement now will prepare market participants, clearing entities, and regulators for increased coordination in the future.

VI. Additional Areas of Concern

Safe and efficient linkages will require further efforts at coordination. Some items for future coordination not contained in the Group of Thirty's recommendations include capital adequacy standards for market participants, information sharing among clearing entities about risk positions of joint members, and the interaction of the derivative markets.

A. Capital Adequacy Standards

Adequate capital requirements for market participants are basic to the safe functioning of all securities markets and also are important to the question of sound linkages. Markets, clearing entities, and regulators must examine the adequacy of capital requirements for all market participants and especially for those participating in multiple markets.

A Working Group of the Technical Committee of the International Organization of Securities Commissions ("IOSCO") has been studying the issues related to capital adequacy for non-bank securities firms from a world-wide perspective and is currently exploring suggestions that risk based capital adequacy standards should be adopted.

Additionally, the Committee on Banking Regulations and Supervisory Practices ^{7/} has designated a working group on position risk on traded securities that currently is exploring issues related to a risk-based capital approach for banks' securities positions. This initiative is consistent with banking regulator concern regarding bank safety and soundness. At the request of the group, the SEC has designated a representative to assist the group in its deliberations.

Capital adequacy standards for both banks and non-bank participants in international securities markets are critical components in reducing risks entailed in cross-border

^{7/} The Committee was formed under the auspices of the Bank for International Settlements located in Basle, Switzerland.

transactions. Efforts to promote sound capital adequacy standards, including risk based standards, should be encouraged and supported.

B. Information Monitoring and Sharing

Another important component of sound market linkages is agreement by clearing agencies to monitor information about the financial and operational condition of participants in multiple markets and to share that information with clearing entities in those other markets. U.S. clearing agencies serving the equity and equity options markets have formed the Securities Clearing Group, or "SCG," to accomplish this objective. The SCG members have agreed to work toward a system of sharing settlement, margin, and position information about joint members. As international clearing linkages develop and mature, a similar international initiative also should be undertaken.

At the regulator level, the Commission has entered into an information sharing agreement with certain U.K. regulators that provides that the U.K. regulators will waive their capital adequacy requirements with respect to particular U.S. broker-dealers that have branches in the U.K., if the U.S. regulators provide certain information to the U.K. regulatory authorities. The Commission has agreed to notify the U.K. regulators if it becomes aware that a particular broker-dealer's financial or operational condition is impaired, and U.K. regulators have agreed to notify the Commission if they become aware that a U.K. branch of a U.S. broker-dealer has a substantial problem. The

Commission also is discussing with foreign regulators the exchange of information with respect to affiliates of regulated entities. In addition, the United States has been exploring bilateral agreements on the subject of sharing information for enforcement purposes, and, through IOSCO, is looking into the feasibility of multilateral agreements as well.

Development of good monitoring practices and information sharing agreements at both the clearing entity and regulator level will be an important aspect of a sound worldwide clearance and settlement system. Coordination in these areas should proceed as part of the effort to establish these systems.

C. Futures and Options Derivative Markets

The strong emphasis on coordination to enhance the safety of the clearance, settlement, and payments systems should apply across all markets, and especially the derivative markets in options and futures. In my October paper, I noted that one important lesson learned about clearance and settlement during the October 1987 market break is the urgent need for coordination among clearance and settlement systems in the stock and derivative markets. It became clear in October 1987 that a failure of one clearing entity or one major participant in the stock market or derivative market may pose a threat to systems in the same or related markets, with resulting potential negative impact on the banking system. Even without clearing linkages, the failure of a major participant operating in both the stock

and derivative markets could result in great danger for the entire system.

Moreover, as we learned during the October 1987 market break, the world's markets have become increasingly interdependent. Thus, the potential for system-wide disaster also exists across national borders where there is sufficient trading volume. As derivative markets grow in importance abroad, their potential impact on the safety and efficiency of the securities markets will grow. Interfaced and coordinated clearance and settlement systems are vital. I therefore urge all of you, when implementing this blueprint for the future, to keep in mind the derivative markets, both domestic and international.

VII. Conclusion

The Group of Thirty recommendations deserve serious consideration. The Commission is willing to assist in efforts to evaluate and implement the recommendations, efforts that are consistent with its responsibility to foster safe and efficient clearance and settlement of securities transactions. We will be supportive of implementation efforts in all areas. In particular: we will continue to monitor progress toward next day comparison for all stock markets; we will work closely with the stock clearing agencies to develop a practicable timetable for an earlier settlement period; and we will participate in discussions of same day funds settlement. Finally, the Commission continues to be concerned about the additional areas

noted -- capital adequacy, information sharing, and coordination with the derivative markets -- and expects to focus on ways to bring about those complementary improvements as well.