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Department of Trade and Industry
SECURITIES AND EXCHANGE COMMISSION
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MARKET REGULATION DEPARTMENT

SEC-MRD Opinion No. 01
Series of 2010

28 April 2010

AUSTRALIA AND NEW ZEALAND
BANKING GROUP LIMITED
9th Floor, MCC Center, 6778 Ayala Avenue
Makati City
Fax. No. 818-8112

Attention: *Mr. Ricardo D. Peña*
Vice President, Senior Operations Manager

Subject: *Delivery versus Payment (DvP)*

Gentlemen:

This refers to your request for opinion on the issue whether or not the settlement procedures of your bank with qualified institutional buyers (QIBs) with regard to your government securities (GS) transactions outside of the eDVP system of PDEX achieve delivery versus payment, and hence compliant with SEC Memorandum Circular No. 14, series of 2006, otherwise known as the Rules Governing the Over-the-Counter (OTC) Market.

In particular, you cited Section 20 (B) of the OTC Rules which requires that "the clearing and settlement arrangement in the exchange of assets subject of the trade shall be delivery versus payment (DVP) scheme".

In reply, herein below is our response to your query:

This is not the first time our office is addressing this issue. In *SEC-MRD Opinion No.1 dated 28 July 2008*, we described the different approaches of achieving DVP in securities transactions. We also discussed extensively the different settlement systems in the domestic equities and fixed income markets. We also made a ruling on similar issue in *SEC-MRD Opinions No. 2 and 3 dated 8 October and 13 November of 2008 respectively.*

The process of clearing and settling securities trade includes several key steps. *First*, the confirmation of the terms of trade by the market participants. *Second*, the calculation of the obligations of the counterparties resulting from the confirmation process which is known as clearance. *Third*, the final transfer of securities (delivery) in exchange for the final transfer of funds (payment) in order to settle the obligation which is known as settlement.

A DVP system is a securities settlement system that provides a mechanism that ensures that delivery occurs if and only if payment occurs. It is a procedure by which the buyer's payment for securities is due at the time of delivery. The purpose of DVP system is to ensure that counterparties are not exposed to principal risk, that is, the risk that the seller of a security could deliver but not

receive payment or that the buyer of a security could make payment but not receive delivery. *[CPSS, Delivery Versus Payment in Securities Settlement Systems (BIS, September 1992)]*

Strictly speaking, DVP does not require simultaneous final transfers of funds and securities. When a central securities depository does not itself provide cash accounts for settlement, it first blocks the underlying securities in the account of the seller or his custodian. It then requests transfer of funds from the buyer to the seller in the settlement bank. The securities are delivered to the buyer or his custodian if and only if the central securities depository receives confirmation of settlement of the cash leg from the settlement bank. *[CPSS, Recommendations For Securities Settlement Systems (BIS, November 2001)]*

In your request, you seek confirmation that the settlement procedures of Australia and New Zealand Banking Group Limited (ANZ) relative to your GS transactions with QIB clients achieve DVP. Based on your letter, your bank's settlement procedures can be described as follows:

A. ANZ is the BUYER, Counterparty/Custodian Bank has RoSS-Telerate terminal

1. ANZ Operations receive trade details from ANZ Front Office (VD-1)
2. Trade details are confirmed with counterparty/custodian bank (VD-1)
3. Counterparty/Custodian (Seller) inputs transaction into RoSS-Telerate (VD)
4. Upon sighting of Seller input, ANZ (Buyer) responds on Telerate and remits payment as per Counterparty/Custodian instructions
5. Counterparty/Custodian confirms receipt of payment and replies back on Telerate (before 1:30pm, VD)
6. Immediately after, transaction is sent to BTr-RoSS for posting
7. Security is automatically transferred once trade is marked "P" (Posted) in RoSS system

B. ANZ is the SELLER, Counterparty/Custodian bank has RoSS-Telerate terminal

1. ANZ Operations receive trade details from ANZ Front Office (VD-1)
2. Trade details are confirmed with counterparty/custodian bank (VD-1)
3. ANZ (Seller) inputs transaction into RoSS-Telerate (VD)
4. Upon sighting of Seller input, Counterparty/Custodian (Buyer) responds on Telerate and effects payment as per ANZ instructions
5. ANZ confirms receipt of payment and replies back on Telerate (before 1:30pm, VD)
6. Immediately after, transaction is sent to BTr-RoSS for posting
7. Security is automatically transferred to buyer once trade is marked "P" (Posted) in RoSS system

** Note: RoSS system checks the securities in the seller's securities account and earmarks these for transfer. Once the buyer has confirmed transaction details, the RoSS system will automatically transfer the earmarked securities from the seller's securities account to the buyer's securities account. Trade status will then be marked as Posted "P" in the system.

C. ANZ is the BUYER, Counterparty has RoSS account but no Telerate terminal (Manual settlement)

1. ANZ Operations receive trade details from ANZ Front Office (VD-1)
2. Trade details are confirmed with counterparty (VD-1)
3. ANZ prepares Confirmation of Purchase (CoP) and Counterparty prepares Confirmation of Sale (CoS) (VD-1)
4. ANZ sends signed CoP via facsimile to Counterparty (Seller) (before 10am, VD)
5. Counterparty (Seller) matches CoP and CoS and advises ANZ (Buyer) that all is in order (before 11am, VD)
6. Upon confirmation that CoP and CoS are matched, ANZ effects payment to Counterparty via PhilPass RTGS (before 11AM) and advises Counterparty of the same

7. Counterparty faxes matched CoP and CoS to Bureau of Treasury immediately upon confirmation of payment
8. ANZ telephones BTr-RoSS to confirm transfer of securities
9. ANZ sends original CoP to Counterparty who subsequently sends both original CoP/CoS to BTr

D. <u>ANZ is the SELLER, Counterparty has RoSS account but no Telerate terminal (Manual settlement)</u>

1. ANZ Operations receive trade details from ANZ Front Office (VD-1)
2. Trade details are confirmed with Counterparty/custodian bank (VD-1)
3. ANZ prepares Confirmation of Sale (CoS) and Counterparty prepares Confirmation of Purchase (CoP) (VD-1)
4. Counterparty sends signed CoP via facsimile to ANZ (Seller) (before 10am, VD)
5. ANZ (Seller) matches CoP and CoS details and advises Counterparty (Buyer) that all is in order and to remit payment (before 11am, VD)
6. ANZ faxes matched CoP and CoS to Bureau of Treasury immediately upon confirmation of payment
7. ANZ telephones BTr-RoSS to confirm transfer of securities
8. Counterparty sends original CoP to ANZ who subsequently sends both original CoP/CoS to BTr

Under the aforementioned procedures, it appears that settlements will be done on a per deal basis and will not involve netting or off-setting of transactions.

These procedures and safeguards ensure that each transfer of securities is effected only when payment occurs or assured within the settlement cycle. As earlier mentioned, DVP does not require simultaneous final transfers of funds and securities. It is essential though that the securities are delivered to the buyer or his custodian if and only if it is confirmed that the cash aspect of the transaction is paid. Thus, in our view, the settlement arrangements described in your letter and Manual of Procedures achieve DVP.

It is understood though that the foregoing opinion is rendered based solely on the facts you disclosed and described in the query and relevant solely to the particular issue raised therein and shall not be used in the nature of a standing rule binding upon the Commission in other cases whether of similar or dissimilar circumstances. *[SEC Memorandum Circular No. 15 (2003)]*

Finally, you are directed that ANZ's Manual of Procedures for GS transactions with QIBs be made part of your records and that the same shall be disclosed to your counterparties and form part of the client agreement.

For your guidance.

Very truly yours,

JOSE P. AQUINO
Director

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