

**TREASURY EXECUTIVE MINUTE**

7 January 1997

File: 9605346

Parliamentary Secretary

**REQUEST FOR APPROVAL OF A PAYMENT FROM THE SECURITIES INDUSTRY DEVELOPMENT ACCOUNT (SIDA) FOR EXPENDITURE ON THE CHESS PROJECT****Action required by:** No deadline but early consideration desirable.

**Purpose:** Approval of the payment of \$4,764,000 from the Securities Industry Development Account (SIDA) for expenditure on the CHESS Project

**Background/Analysis**

2. The Australian Stock Exchange (ASX) has submitted a request for approval of a payment of \$4,764,000 from the Securities Industry Development Account (SIDA) for expenditure on the Clearing House Electronic Clearing System (CHESS) Project in accordance with subsection 945(3) of the Corporations Law.

*The Securities Industry Development Account*

3. The SIDA consists of moneys in excess of the minimum amount required to maintain the National Guarantee Fund (NGF). The NGF provides compensation to investors who suffer loss of money or property (other than loss arising from market changes in the values of securities) as a result of dealing with members of the ASX in connection with the sale or purchase of securities. As at 30 June 1996 the NGF stood at around \$143 million. It has been built up over the years from the investment of assets of the fidelity funds of the former State based exchanges (which merged to form the ASX in 1987) and interest on clients' trust account deposits lodged by brokers with the ASX.

4. The minimum amount required to maintain the NGF is \$70 million. Amounts in excess of this may be transferred to the SIDA. Under sec 945(3) of the Corporations Law the Minister may approve in writing payments out of the SIDA where the funds are spent for a purpose relating to development of the securities industry in Australia.

*Memorandum of Arrangement governing the CHESS project*

5. The Minister in the previous Government responsible for the Corporations Law gave in-principle approval for the release of up to \$35m from the SIDA to fund the CHESS project. Payments were to be approved on a periodic basis in accordance with a Memorandum of Arrangement (MOA) entered into between the ASX and the Department relating to supervision of the project. Costs in excess of \$35m were to be met by the ASX. Under the MOA the previous Minister authorised the Department to exercise his discretion under subsection 945(3) to approve payments out of the SIDA. Under clause 9.2 of the MOA payments from SIDA are subject to the Department's written approval. A copy of the MOA is at Attachment A.

6. CHESS has been introduced in two phases. The first phase of CHESS automated the transfer of securities and establishes an electronic subregister of the principal share register of all companies that have CHESS-approved securities. The second phase links CHESS to the funds transfer system of the Australian banks. Phase 1 has been completed. Phase 2 commenced on 11 April 1996.

7. The introduction of CHESS is one of the ASX's most notable achievements. The efficiencies resulting from CHESS were sufficient for Global Securities Consulting Services of the UK to rate the settlement performance of ASX's equities market in 1994 as second only to the United States in the world. The completion of this project enhances the international competitiveness and the profile of Australia's financial markets and reflects well on the Australian Government since it has been closely involved with the project from inception to final implementation and has approved funding of it under the SIDA.

8. This is the final payment to be made for the CHESS project under the MOA between the ASX and the Department.

9. The previous Government authorised the Department to approve payments under the MOA. While it would be open to you to continue this practice and authorise an officer of the Treasury to exercise your power under subsection 945(3), as this is the final payment, we suggest that it would be appropriate and convenient for you to approve this last payment. A description of the relevant clauses that are taken into account in approving requests for payment under the MOA is at Attachment B.

10. Under the MOA it has been the practice for the ASX to submit a request for approval of a payment together with a report on the period in question to the Department and the ASC for evaluation. The request usually includes a current assessment of *risks* that may affect the establishment and viability of the project. Also a report by an independent auditor confirming the expenditure in question accompanies the ASX's request. In this way officers of the Department and the ASC are able to monitor the progress of the project and ensure financial accountability for funds spent by the ASX and also obtain advance warning of any emerging problems. If the report is satisfactory and in accordance with the MOA the Deputy Secretary of the Attorney-General's Department would approve payment. To date \$29,887,915 has been approved for payment under subsection 945(3) in relation to the CHESS project.

11. A list of these payments and the approving officers is at Attachment C. Senator Gibson approved the latest payment.

12. During the course of the project the ASX requested a variation to the procedures for making requests for payment. It sought an extension of the period for which claims could be made from three months to five months. It also sought to have certain implementation costs associated with Phase 1 of CHESS treated as "expenditure incurred for the purposes of the CHESS project". The previous Government approved these variations.

#### *The Request for Payment*

13. The present 'Request for Payment' (the Request) addresses the main activities undertaken by the project during the period 1 December 1995 to 19 August 1996 and highlights any problems and risks that impact on the project's final implementation. A copy of the Request, including the independent auditor's report, is at Attachment D.

14. The Request seeks approval for a payment of \$4,764,000. This amount comprises expenditure of \$3,786,000 for items specified in the CHESSE project budget and \$978,000 on implementation costs for the same period. The total project expenditure comes to \$34,651,915 including implementation costs. This is within the \$35m limit specified in the MOA governing payments from the SIDA.

15. The main achievements of the period of review were the completion of the development of CHESSE Phase 2, implementation of the settlement facilities and upgrading equipment capacity to full load. Software problems that were initially encountered in aligning CHESSE participants with the settlement system have been overcome. As at 30 September over 55% of the ASX market capitalisation for domestic securities (representing approximately \$201 billion) is registered on CHESSE.

16. There are two unresolved issues that have emerged from the CHESSE project - the bringing of securities of foreign domiciled issuers into the CHESSE system and arrangements for the holding of uncertificated securities as collateral by financiers. The first issue arises from the fact the laws of some foreign jurisdictions do not recognise uncertificated securities. The ASX has responded to this problem by creating a legal and procedural vehicle to enable securities of foreign companies listed on ASX to settle through CHESSE. It remains to be seen how effective this vehicle is. The ASX is optimistic that it will prove acceptable to foreign issuers.

17. The second issue arises as a result of criticisms of law firms and financiers of the efficacy of the means for pledging securities in the CHESSE environment. The ASX has been discussing this problem with the banks and is confident that it will be able to resolve their concerns.

#### *ASC view*

18. The ASC undertook a review of this payment approval request. A copy of its report is at Attachment E. It drew attention to the following matters:

- Equipment costs were put at \$1,466,000, whilst the CHESSE Project expenditure indicated that the budgeted figure was \$233,000 while the KPMG section of the report stated that it was nil;
- KPMG reported that Staff Costs for permanent staff in the period increased from a budgeted figure of \$470,000 to \$955,000, neither of these figures reconcile with figures that appear in the Appendix 1 report.

19. The Department wrote to the ASX seeking an explanation for the discrepancies mentioned above. The ASX explained that the differences arose from the different budgeting arrangements, in that ASX Financial Budgets are fixed for a particular year whereas Project Budgets are reviewed for every reporting period. The budget variances for contractors, occupancy, travel and administration are essentially attributable to the timing variance in the project completion date. A copy of the ASX's response to the Department queries is at Attachment F.

20. On balance it would seem that CHESSE has been successfully implemented and is now an integral part of the securities industry. In our view there are no major outstanding problems disclosed in the Request, in the report of the independent auditor or in the ASC's review.

**Recommendation:**

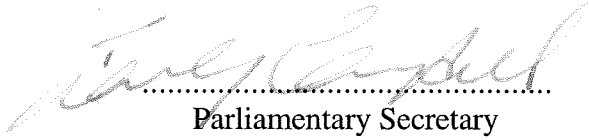
21. I recommend that you approve the release from the Securities Industry Development Account of \$4,764,000 in respect of the period 1 December 1995 to 19 August 1996 by signing the letter to the Managing Director of the ASX Settlement and Transfer Corporation Pty Ltd, Mr Angus Richards, at Attachment G.

Section 22

Assistant Secretary  
Securities Markets Branch

Contact Officer: Section 22  
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APPROVED/~~NOT APPROVED~~  
LETTER SIGNED/~~NOT SIGNED~~



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Parliamentary Secretary

29 / /1997



**PARLIAMENTARY SECRETARY  
TO THE TREASURER**

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Mr A Richards  
Managing Director  
ASX Settlement and Transfer Corporation Pty Ltd  
PO Box H227  
Australia Square  
SYDNEY NSW 2000

Dear Mr Richards

I refer to your letter of 8 November 1996 requesting approval for the release of funds from the Securities Industry Development Account for expenditure incurred on the CHESSE project for the period 1 December 1995 to 19 August 1996.

I approve the release from the Securities Industry Development Account of \$4,764,000 in respect of the above period.

I take the opportunity to congratulate the Exchange on the completion of this important project. The introduction of the automated delivery-versus-payment settlement system, CHESSE, can only serve to enhance the efficiency and reputation of the Australian securities markets.

Yours sincerely

Senator the Hon. Ian Campbell