

**Scripless Securities Settlement System
and
the Central Depository System**

Questions & Answers

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1. What are Scripless Government Securities?

The government securities such as Treasury Bills and Treasury Bonds are being issued at present in the form of paper certificates. They are called scrip securities. The scripless securities are issued in data entry form without a paper certificate. To enable the issuing and recording of transactions on scripless securities, a computer based central depository and a settlement system will be installed. When securities are transferred from one to another the central depository will record such title transfers. These securities will be settled through an electronic settlement called Scripless Securities Settlement System (SSSS). The SSSS and the central depository are named as 'LankaSecure'.

2. What are the reasons for moving from scrip to scripless Securities?

The main reason for moving from scrip to scripless form is to improve efficiency in the government debt securities market by improving secondary market trading and eliminating risks associated with paper based securities. Since the System will operate electronically on-line, trading will be convenient to all market participants i.e. primary dealers, banks and investors. Under the proposed system, the Central Depository System (CDS) will be the registry as well as the custodian for government securities. The ownership of securities will be recorded electronically in the CDS. At present, the transfers of securities done by manual endorsement. This will be a very safe system for holders of government securities to maintain records of their ownership. The corresponding payments for securities or settlement of funds in scripless securities is based on a Real Time Gross Settlement System (RTGS) through which funds will be settled instantaneously on real time.

3. What is Central Depository System (CDS)?

The Central Depository System (CDS) is a computer based data recording system which records the holdings of government securities. This will be a customer based depository. At any given point in time, the holders of scripless securities in the CDS will be able to obtain confirmation for their holdings. The transfer of holdings of scripless securities will be recorded electronically in the CDS according to instructions received from participants of the System i.e. primary dealers and licensed commercial banks. The CDS will be linked to participating institutions which trade in government securities. The CDS will issue monthly statements confirming the balances held by the investors in government securities. The CDS will also advise the parties involved in a transaction whenever a transaction is carried out within the System.

4. What is Scripless Securities Settlement System?

The Scripless Securities Settlement System (SSSS) will enable the settlement of government securities transactions electronically, online in a computer based system. Whenever, a transaction takes place, securities will be transferred from one account to another. In an outright buying and selling transaction, for instance, there will be a buyer who will receive securities and his account will be credited with securities and the seller's securities account will be debited. The buyer of securities will pay money through the RTGS which is instantaneous. Given these electronic and efficient systems, it is expected that there will be a large number of transactions taking place in any given business day in the government debt securities market. The settlement of securities on account of all these transactions will be recorded through the SSSS.

5. Who are the participants of the CDS and SSSS?

There are two categories of participants in the CDS and SSSS. They are

- (a) Primary dealers and licensed commercial banks who are called 'dealer direct participants' and
- (b) any other institution permitted by the Monetary Board who are called 'direct participants'.

The 'dealer direct participants' will maintain accounts on their own account and on behalf of their customers. The direct participants will maintain accounts only on their own account.

6. Where will the CDS be located?

The CDS will be installed and maintained in the Public Debt Department of the Central Bank. Both dealer direct participants and direct participants will be linked online to the CDS.

7. Do individual customers/investors need to open and maintain accounts in the CDS?

Accounts will be opened through dealer direct participants of the CDS, i.e. primary dealers and licensed commercial banks on their own account and on behalf of their customers for recording and changing ownership of scripless securities. Each investor will have a separate account in the CDS. Movement of securities and outstanding positions of investors are electronically recorded in these accounts.

8. What kind of information is required to open an account in the CDS?

Investors have to provide name, address and their personal details such as the national identity/passport number to open an account in the CDS. Since the primary dealers and licensed commercial banks are the dealer direct participants of the CDS, investors have to provide this information to the primary dealer or

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licensed commercial bank from whom securities will be purchased. Upon receipt of required information from the investor, the relevant participant will communicate with the CDS and take steps to open an account and record the securities transactions by the investor. The main difference between the existing system and the proposed system is that transactions in the proposed system will take place in scripless form electronically and the CDS will maintain the records whereas in the existing system the certificate has to be endorsed by holder to transfer it to another person.

9. How and on what basis will ownership be recorded in the CDS?

Accounts of investors will be maintained in the CDS by dealer direct participants. The investors will have to deal with the CDS through primary dealers and commercial banks. The instructions by an investor regarding a transaction should always be sent to the CDS through a primary dealer or a licensed commercial bank with whom the investor maintains his securities account.

Ownership of scripless securities will be recorded with details such as name, national identity number, address etc. in the case of an individual investor. The accounts will also indicate the type of securities i.e. Treasury Bills and Treasury Bonds, maturity, date of purchase and value.

10. How and on what basis will the ownership be determined in repurchase (repo) transactions?

A repurchase (repo) is a sale of securities with an agreement to buy back. Once the buyer and seller of a repo have agreed on the terms of the repo, the details of the transaction will be reported to the CDS. There will be a separate account in the CDS for recording the repo transactions. After the funds are settled for the underlying repo transaction by the buyer, the ownership of securities will be transferred to his repo account in the CDS.

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However, the procedure for recording is quite similar to that of outright transactions. There is provision for freezing securities under repos preventing further transactions on the securities that have been given for the repo. On the reversal date, the buyer and seller are expected to settle their obligations through reversing entries in the repo account held in the CDS.

11. What are the advantages of the SSSS to the investor?

Investor's risks associated with holding and trading of paper based securities will be totally eliminated under the SSSS. The investor will not experience the hassle of dealing with physical certificates of government securities as at present. The new system will operate on Delivery Vs Payment (DVP) basis. The other advantages in the SSSS include saving of time as the system will operate more efficiently. The efficiency of the system will improve liquidity in government debt securities market thus benefiting the investor as dealers can reduce their margins due to enhanced liquidity. Further, investors will have access to an advanced system which will operate on the state-of-the-art technology.

12. What is the role of intermediaries in the SSSS?

Primary dealers and licensed commercial banks who are dealer direct participants of the system also play the role of intermediaries in the CDS and SSSS. The SSSS will be based on an on-line connection between CDS and its participants. Primary dealers and licensed commercial banks also act as custodians for their customers in the CDS. This role of custodianship has the following responsibilities.

- ◆ to promptly and accurately record the name, address and national identity number/passport number or company registration number of the customer in the CDS when a customer obtains legal ownership of a security;

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- ◆ to promptly and accurately record any change of ownership of a security.
- ◆ to account and make payment to, on any coupon or maturity proceeds due to a customer.
- ◆ to effect transactions on their customer's behalf, provided such transactions are legal and do not place the participant in breach of the system rules.

13. How will the new System contribute to reduce risks?

Generally, government securities are free of credit or default risk. Under the new system, since the records of transactions and holdings are maintained electronically in a centralised database with a hot back up, the risk of technical failure is minimum. Furthermore, account holders can view their positions of holdings in the system at any time through 'browser workstation' made available to system's participants. Thus scripless securities will eliminate the risk that is associated with scrip securities.

14. Would the CDS maintain records of each and every investment?

Yes. The investor-wise records of transactions will be maintained in the CDS. The CDS will be a registry of transactions and holdings of securities. It will also be the custodian. Accounts in the CDS are defined according to participant accounts, customer-owner accounts and other types of accounts. Accounts will be created automatically in the CDS based on the instructions received from participants.

15. Who will issue letters of confirmation to investors?

The CDS in the Central Bank (Public Debt Department) will issue the following statements to the account holder.

- (a) A statement confirming the transactions that took place

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during the day. If no transactions have taken place during the day, no statement will be generated by the system

- (b) A statement confirming the outstanding balance held by each investor as at end of each month/quarter.
- (c) A statement indicating the maturity proceeds and/or interest payments whenever such payments are made to an investor.

These statements will be issued directly to the name and address of the investor, as registered in the CDS.

16. What is the authenticity of a statement issued by the CDS?

The statements issued by the CDS will provide official confirmation of the securities holdings or transactions that have taken place. In addition, all investors through their respective participant of the CDS can view details of their accounts with the CDS through 'browser workstation'. This will enable the investor doubly confirm the accuracy of the statement issued by the CDS.

17. Is the statement issued by the CDS transferable and tradable?

The statement issued by the CDS is not a transferable or tradable instrument and it will only serve the purpose of confirming either a transaction or holdings of securities by an investor.

18. Can the statements of confirmation be pledged as a security, say to obtain a loan?

The statements issued by the CDS may be used as evidence of holding of securities. However, there is a risk of producing an old statement of which securities have since been sold. Therefore, a statement of confirmation issued by the CDS may not always indicate the current ownership or holdings of securities by an investor.

19. If an investor wants to change his personal particulars in the CDS account, whom should be contacted?

To notify any changes, the customer/investor should contact the primary dealer or licensed commercial bank who maintains his/her account in the CDS. Changes will be made on the instructions received by the CDS from the investor through the relevant primary dealer or the licensed commercial bank.

20. In the event of a discrepancy in the statement, whom should be contacted?

Any clarification regarding a statement should be referred to the party who has issued the statement. If the statement has been issued by a primary dealer or a licensed commercial bank any inquiry should be directed to the respective primary dealer or the licensed commercial bank. Similarly, if the statement has been issued by the CDS, any inquiry should be referred to the Public Debt Department of the Central Bank.

21. Can a customer/investor make online inquiries regarding the status of his/her investment?

Yes. This can be done only through a participant of the system, with whom the customer/investor maintains his account(s) in the CDS. Through the system called "browser workstation", account holders (both participants and customers) can view their positions without any payment.

22. How does an investor access information residing in the CDS?

The system's participants i.e. primary dealers or licensed commercial banks can access CDS accounts for information through "browser workstation" which will facilitate viewing his

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customer accounts as well. The customer inquiry will be directed to the CDS by the relevant system's participant. This is a facility available in the System in addition to the statements issued by the CDS. No system's participant will have access to information relating to accounts maintained by the other participants.

23. What are the charges of the SSSS and CDS?

Primary dealers and licensed commercial banks may charge their customers to cover the cost that they may incur on account of any SWIFT messages and to cover any charges levied by the RTGS. SWIFT is the safest, world wide accepted messaging system used for financial transactions. It is a standard format which will be used by all participants in this System. The SSSS and CDS will operate on the SWIFT messaging system. The RTGS will charge a fee for transactions as determined by the Central Bank. There will not be any charge on either the participant or the customer for the statements issued by the CDS.

24. Will the revenue authorities have access to the records of investments in the CDS?

Information recorded in the SSSS and the CDS will be treated strictly confidential. There will not be any access to information in these systems by any authority or individual other than the Central Bank. The participants of the System will have limited access to information relating to their customer holdings and accounts maintained on their own behalf.

25. Who will have the access to customer records in the CDS other than the participants of the System?

The Central Bank will have access to records in the CDS. However, the Central Bank will use only aggregate information for analytical purposes and for releasing information to the market. The Central Bank will also use aggregate information in its

regulatory and supervisory work. Under no circumstances, the Central Bank will use individual customer specific information.

26. Can an investor/customer appoint a nominee for his/her investment?

The primary dealers and licensed commercial banks will act on instructions from their customers. An investor/customer may appoint a nominee and the procedure will be outside the CDS.

27. How do investors collect maturity proceeds and coupon payments under the new system?

The maturity proceeds and interest payments will be computed on the due dates by the CDS. There will not be any change to the formula of computation and procedures adopted at present. Payments will be made to the registered holders through respective primary dealers and licensed commercial banks in the same way as such payments are made at present. Primary dealers and licensed commercial banks are responsible for making payments to respective investors/customers.

28. Will the reminders to investors regarding maturity and interest payments are generated by the CDS?

There will not be an advance reminder regarding payments. However, the account holders will be informed individually by the CDS about payments that will be made to a system's participant (i.e. primary dealer or a licensed commercial bank) on account of each investor. The respective primary dealers and licensed commercial banks will issue advance notices regarding payments to their customers.

29. Whom should an investor advise for re-investment of maturity proceeds and coupon interest payments?

An investor can advise the primary dealer or licensed commercial bank with whom the maturing securities are held for reinvestment of maturity proceeds and coupon payments. The investor/customer can make prior arrangement with a primary dealer or a licensed commercial bank regarding the reinvestment of maturity proceeds or coupon payments on the same day on which maturity proceeds/coupon payments are received thus maximising the benefits.

30. What will happen in the case of a death of a holder of securities?

There is no change to the procedure adopted at present in regard to an investment of a deceased party. Claims regarding an investment of a deceased should be sent to the primary dealer or licensed commercial bank with whom the deceased party has maintained the CDS account.

31. How safe is the data stored in the CDS?

Security features of the CDS are very advanced. Accessing the system will be restricted only to authorised officers of the Central Bank. In addition, there will be a back-up site where records are updated automatically and simultaneously with the CDS. The service providers have ensured maximum safety available in similar systems used in other countries in the world.

32. In a system failure or disaster what are the recovery methods?

The Central Bank will have a disaster recovery plan for the SSSS and the CDS. In the event of a failure of the system, facilities will be available to continue operation from the back-up sites.

33. Is there a possibility of securities being stolen/lost?

In the CDS the records are maintained electronically and they cannot be stolen/lost. The records are updated concurrently as and when the transactions are carried out. Transmission of information on transactions from the participants to the CDS takes place within a matter of a few seconds. Therefore, there is no time lag in executing a transaction and hence the probability of omissions in the process would be minimal.

34. Who will take the responsibility for maintaining confidentiality of information in the CDS?

Participants of the CDS will sign an agreement with the Central Bank for maintaining strict confidentiality of the information. The information for which the system's participants have access will always be treated confidential. As mentioned elsewhere earlier, each CDS participant will have limited access to information relating to the accounts that are maintained by that participant on his own account and on behalf of his customers' accounts.

35. What are the operating hours of these systems during a business day?

LankaSecure will be available for operations on all business days from 8.00 a.m. to 3.00 p.m. The participants of the system and their clients must ensure that they complete the day's transactions before the system closes at 3.00 p.m. 'LankaSecure' will not be open for business on public and bank holidays.

36. What is the minimum value of investment that can be made in scripless securities?

Scripless securities will be issued with minimum face value of Rs. 10,000/- and any higher denomination in multiples of Rs.10,000/- Transactions in the System will specify the securities to be transferred in number of units. One unit is equivalent to the

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minimum face value i.e. Rs. 10,000/-. The minimum marketable parcel of securities will also be one unit i.e. Rs.10,000/-.

37. Will scrip securities be available if required?

There will not be scrip securities once 'LankaSecure' has commenced operation. The Central Bank will start issuing securities only in scripless form when 'LankaSecure' is scheduled to be fully operational. Transactions in the CDS will be possible only in scripless form.

38. How will the instructions be given for transferring securities in the CDS?

Securities will be moved from one account to another in the CDS on a request made by a customer through the relevant CDS participant. Once the deal is agreed upon by the counter parties involved, transaction will take place on any of the following basis as the case may be i.e. Delivery Vs Payment (DvP), Receive Vs Payment (RvP), Deliver Free (DF), Receive Free (RF) and Repositioning

Investors have to go to a primary dealer or a licensed commercial bank in order to initiate a transaction in the System. Trading can be initiated by originating a message from the computer-based terminal of a participant. If the transaction is between two parties, both parties have to agree with the terms and conditions of the transaction. Once the transaction is matched, the securities will be moved from the seller's account to the buyer's account. The corresponding funds transfer will take place through the RTGS.

39. How will the settlement of funds and securities take place simultaneously?

Whenever there is a securities transaction pending, the system will check whether funds are available in the RTGS account. To enable the securities transaction to take place, funds should be available in