

Settlement of transactions in the gilt-edged securities market

This note describes the settlement arrangements which the Bank of England and The Stock Exchange are jointly developing for a computerised book entry transfer system in gilt-edged securities and for accompanying assured payments. These arrangements will be provided through the Central Gilts Office, which has recently been set up to meet the demands of the changes taking place in the gilt-edged market.

For many years the Bank, as registrar for UK government and certain other securities, maintained clerically, within an office usually known colloquially as Jobbers' Counter, a set of running (or 'certifiable') balances in these securities for the main market participants, ie the jobbers, the discount houses and various bank nominee companies which hold stock on behalf of those institutions which have been authorised to act as stock lenders. These balances allowed the holders to receive and deliver stock without waiting for the underlying transfer of ownership to be recorded on the main register, which normally took another two to three days. Without the provision of these certifiable balance facilities, participants in the market would not be able to settle on one day those transactions which they had effected the previous day, and thus the liquidity of the gilt-edged market would have been severely restricted.

The decision to move from the clerically-based system to a computerised one was taken well before it became apparent that there were to be fundamental changes in the structure of the stock market. Although there is a vital connection between the two, the antecedents of the Central Gilts Office (CGO) project go back to the 1970s and particularly to a report prepared by the Joint Committee on Gilt-Edged Settlement, which had been set up jointly by the Bank and The Stock Exchange under the chairmanship of Mr G D Burnett (a former director of National Westminster Bank). Under its terms of reference this committee was required to 'obtain agreement on measures necessary to ensure the reliable and effective settlement of this type of business [ie in gilt-edged and related securities] through the next decade and beyond'. The committee's main recommendations were that a computerised book entry transfer system should be set up to hold records of balances on members' book entry stock accounts; that members should communicate with the system by means of terminals linked to a central computer; and that transfers should take place on the basis of agreed transactions.

After consideration of the recommendations, the Bank and The Stock Exchange agreed to set up a project to establish a system along the lines proposed which would be run from an office within the Bank. The project was to be funded jointly, with control vested in a Joint

Management Committee (JMC) chaired by Mr G M Nissen (now Senior Partner of Pember & Boyle) and comprising members of the two parent bodies.

Work commenced in 1980 on a system designed to serve the existing market and therefore taking account of prevailing structure and practices. One of the cornerstones of the design was the receipt of bargain information from The Stock Exchange's central Checking system, which undertakes the matching of bargains arranged between members of The Stock Exchange. By 1983 considerable progress had been made in defining the requirements, designing the system, and the early stages of the programming; but early in 1984 it became apparent that significant changes would be needed, as a result of the agreement between the Government and The Stock Exchange which led to the withdrawal of the restrictive practices reference on minimum commissions, because it was no longer possible to base the system on the concept of single capacity for Stock Exchange member firms. Even then, it still seemed possible to use what had already been developed; so, while work continued, a separate exercise was initiated which first looked at the feasibility of revising the design so as to embrace the concept of dual capacity and then, when it became apparent that this route would require a development timescale running well into 1986, examined alternatives.

At the same time as the project was undertaking its review, The Stock Exchange was also looking at the changes which would be required to its own settlement processes and the implications which these would have on a link between Checking and the CGO Service. Finally, the JMC decided that overriding priority should be given to introducing the central part of the CGO system, namely a computerised system to replace the clerically-maintained certifiable balance accounts in Jobbers' Counter; and that, initially at least, the system should be developed without any links to The Stock Exchange's systems. By restricting the project in this way it seemed that the CGO could be ready by the beginning of 1986, which in the autumn of 1984 was regarded as the earliest possible date for Big Bang (ie the abandonment of minimum commissions by Stock Exchange members and, in consequence, single capacity operations); and, most importantly, this limited development would allow the provision of certifiable

balance facilities for an increased number of market participants at the time of Big Bang. Significantly greater numbers could not have been provided for under the clerical arrangements.

Although this limited development, Phase 1 of the CGO Service, was conceived against the need to put something in place quickly, it was also recognised that it should provide the foundation on which a more extensive service could be constructed in due course. During the fourteen months between October 1984 and December 1985, the Phase 1 system was designed, programmed, tested and finally inaugurated, on schedule, on 2 January 1986. The development work was shared between three separate groups: the project team itself was responsible for the Service requirements, office procedures, training the members and Service trialling; the Bank's Registrar's Department Computer Services undertook the design, programming and testing of the computer system and were also responsible for the installation and establishment of the hardware; and The Stock Exchange's Advance Systems Group were responsible for establishing the communications network—the Integrated Data Network (IDN)—which connects the users of the Service to the CGO computer system.

Although the Phase 1 Service allows members to deliver stock to one another in book entry form directly through the IDN terminals, the single capacity nature of the market and the lack of any facilities for brokers mean that most sales and purchases must at present continue to be settled using stock transfer forms. Furthermore, the initial service only provides facilities for stock movement, rather than a full settlement system, and payments must be effected directly between the parties concerned. The use of the Service for book entry transfers is thus largely restricted to moving stock which is being lent (or subsequent returns) or pledged as collateral. In the same way that movements across Jobbers' Counter balances were subsequently advised to the registrar, deliveries into and out of CGO accounts, whether by book entry or by

stock transfer form, are notified to the registrar so that the main register may be updated. The daily average number of transactions processed by the CGO during the first two months of operation of the Phase 1 Service are set out in the table below. These averages are broadly similar to those for Jobbers' Counter, although the provision of accounts for the first time for the six Stock Exchange money brokers has meant that some pledging of stock as collateral is now being effected by book entry deliveries rather than by way of physical collateral certificates ('overnight chits').

**Average number of transactions per day:
January and February 1986**

Stock transfer forms:	
credits to CGO accounts	1,262
debits on CGO accounts	1,352
Member-to-member movements	920
Total	3,534

At the same time as Phase 1 was being developed, the project team gave urgent attention to the content of Phase 2 of the Service, which the JMC agreed should introduce assured payments arrangements by providing for irrevocable instructions for payment to be generated simultaneously with the movement of stock between CGO accounts. The development of these payment arrangements has entailed extensive discussions with market participants and with the banks currently operating the same-day payment systems, ie CHAPS and town clearing. It has also required the development of a number of extra security features.

Phase 2 is planned to be introduced as part of Big Bang on 27 October 1986; at the same time membership of the Service will be expanded to provide facilities for the new market makers and money brokers and the inter-dealer brokers. Soon afterwards, it is likely that the membership of the Service will be widened to include, for example, broker-dealers and major investing institutions; and, in due course, further phases are likely to add extra facilities to the Service.⁽¹⁾

(1) Further information about the CGO Service and its future development may be obtained from The Manager, Central Gilt Office, Bank of England, 1 & 2 Bank Buildings, Princes Street, London, EC2R 8EU.