

Gilt-edged settlement: recent developments in the CGO Service

This note records the developments since the Bank of England and The Stock Exchange announced in December 1987 that facilities for electronic book-entry transfer of gilt-edged stock were being extended to a wider range of participants.

In the early 1980s the Bank of England and The Stock Exchange agreed to develop jointly a project to provide the major participants in the gilt-edged market with computerised account balances in gilt-edged stock. This became known as the Central Gilts Office Project.

When it became clear in 1984 that there was to be a change in the structure of the gilt-edged market, the Project was replanned on a phased basis. Phase 1, inaugurated on 2 January 1986,⁽¹⁾ allowed the main market participants, ie the jobbers, the money brokers, the discount houses and various bank nominee companies, to effect book-entry transfers of stock through computer terminals, but at that stage payment had to be made outside the Service.

Phase 2 of the Service was inaugurated at Big Bang. This entailed, first, an expansion of CGO membership to include the new market makers and inter-dealer brokers who were to become an integral part of the new gilt-edged market structure and, second, the introduction of assured payment arrangements, together with a range of additional facilities.⁽²⁾

Membership expansion

In developing the Service it had always been the intention of the Bank of England and The Stock Exchange that membership should be open to a wide range of participants in order to minimise the use of paper transfers (stock transfer forms) and maximise the number of transactions settled through the CGO computer system. With the experience of a year's successful operation of Phase 2 of the Service, expansion of membership to include any participant in the gilt-edged market who so wished was announced on 11 December 1987. Two alternative routes were made available:

- direct membership on the same terms as existing memberships; and
- indirect participation via a nominee that is itself a member of the Service.

The choice between these alternatives depends largely on the number of transactions that are to be put through the

system. For the more active participant in the market, direct membership may be more appropriate; however, if the number of trades is small, indirect participation could be the most cost-effective way to participate in the Service.

The CGO has been actively encouraging participation, by demonstrating the CGO computer system to interested parties, by contact with firms who have previously expressed interest in the facilities and by the recent production of a brochure providing an easily-read summary of the Service.

Membership expansion has now provided the opportunity for broker-dealers and agency brokers to participate. During discussions with the broker-dealers about the benefits of the Service it became clear that CGO membership could be of considerable value for those with a large institutional client base who themselves participate indirectly in the CGO via a nominee.

A number of new direct members have been admitted to the Service since expansion of membership was announced, and applications from several more prospective direct members are being processed. However,

Table A
Stock^(a) held in CGO

£ billions, percentages in italics

	Nominal amount of stock in issue	Nominal amount of stock held in CGO	Percentage of stock in issue held in CGO
Oct. 1986	126	25	20
Dec. 1987	140	35	25
Mar. 1988	142	44	31
May 1988	143	45	31
July 1988	141	50	35
Sept. 1988	142	51	36

(a) British government and other eligible stocks.

this is only part of the picture. There is also evidence that indirect participation via a nominee has increased significantly in the period since December 1987. Many of the settlement banks are actively marketing the nominee facility: Table A shows the increase this year in the percentage amount of stock in issue that is held on accounts in the CGO.

(1) The history of the CGO Project and the introduction of Phase 1 on 2 January 1986 were described in the March 1986 *Bulletin*, pages 56-7.

(2) The facilities in Phase 2 of the CGO Service introduced on 27 October 1986 were described in the February 1987 *Bulletin*, pages 80-82.

Despite the increase in the proportion of stock being held in the CGO, the number of paper transfers has remained steady over the last two years (Table B).

Table B
Transfers registered

Thousands, percentages in italics

Year to end-February	1985	1986	1987	1988	1988 H1(a)
Stock transfer forms	1,030	955 96	792 65	793 52	390 55
Electronic transfers through CGO(b)	—	36 4	427 35	728 48	324 45
Total	1,030	991	1,219(c)	1,521(c)	714(c)

(a) 1 March to 31 August.

(b) This facility was introduced on 2 January 1986.

(c) The increase in transfer activity is largely accounted for by the intra-market activity in the new market structure.

The proportion of stock in the CGO could be significantly increased and the use of paper transfers reduced if non-residents introduced their holdings, which a number of existing and potential members are keen to promote. Hitherto there have been a number of administrative difficulties which have restricted the possible expansion of the Service in this area. However, the Inland Revenue has recently agreed arrangements for members to operate a single pooled nominee account, both for superannuation funds and for overseas holders of stock, on which interest is received gross, and for the account to be used for stock lending. Formal application needs to be made by the account holder to the Inspector of Foreign Dividends, Inland Revenue, to introduce overseas-held stock onto such an account.

Operational activity

The average daily workload (the total of book-entry and paper transfers) passing through the CGO in the period from Big Bang to end-August 1988 was between 5,000 and 6,000 items. The highest daily total was 8,742 on 19 March 1987, two days after the 1987 Budget. This peak is comfortably within the present system capacity.

The computer hardware and communications network have so far all proved reliable and robust. Nevertheless, it was decided during 1987 that it would be prudent to invest in a 'hot standby' system which, in the unlikely event of a major breakdown of the main site computer configuration, would enable service to be resumed within an hour; previously it would not have been possible to do this until the next working day. 'Hot standby' has been

available since February 1988 and has since been comprehensively tested without disruption to the Service.

Tariff

A new tariff structure for direct members of the Service has been effective from 1 March 1988; this is designed to relate more closely to usage of the system and consists of three parts:

- (a) a flat-rate membership fee of £8,000 per annum;
- (b) an annual charge of £8,000 per annum per terminal connection;
- (c) a usage-related charge.

The financial objective for the CGO is, when measuring its income against costs, to break even, taking one year with another. Two parts of the tariff, (a) and (b) above, are payable annually in advance. The usage-related charge, which is payable quarterly in arrears, is levied only on non-paper stock debit items passing through the system, for which the charge is currently £4.50 per item (reduced to £2.25 for money brokers and inter-dealer brokers, because of their specialised role in the market), or £1 per item (£0.50 for money brokers and inter-dealer brokers) for small bargains, defined as those having a value of less than £25,000. The present tariff does not make a charge for physical stock deposited into or withdrawn from the system. Although the tariff is subject to review half-yearly, the CGO intends to continue to hold down all its costs, including those which might impact on the tariff. No change was made at the first review, and the structure for 1989/90 is to be considered shortly.

The Service has proved effective and reliable and has been an important ingredient in the successful operation of the gilt-edged market in the last three years. Building on experience, the CGO remains keen to encourage wider participation in the Service in order to achieve a further shift away from paper settlement and to pave the way for the eventual withdrawal of the facility currently provided by the Registrar's Department for the immediate certification of stock transfer forms.

For further information about the Service or to obtain promotional literature, please telephone 01-601 4517 or write to:

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