A-Share DVP Model Reform in China

WFC 2022 Online Event

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Background of A-share DVP Reform
Background of A-Share DVP Reform-What does DVP mean?

01. DVP, short for Delivery Versus Payment, means that securities delivery and cash payment shall be mutually conditioned.

02. CSD settles transactions with its settlement participants.

03. PFMI states that FMIs shall adopt DVP settlement mechanism.

04. DVP is a guarantee for FMIs to run their markets in a safe, efficient and stable way.
What’s the gap between the settlement model of Chinese securities market and standard DVP?

- Direct holding system
- Central deposit of securities
- Tiered settlement

Securities are settled at the end of T+0 and cash at 16:00 pm on T+1

Various ex ante control measures
<table>
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<th>Ex ante Control Measures Applied in Chinese Capital Market</th>
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<td><strong>Front-end monitoring</strong></td>
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<td>• preventing short selling</td>
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<td><strong>Third-party custody of settlement funds</strong></td>
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<td>• preventing brokers from misappropriation</td>
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<td><strong>Full margin requirement for brokerage business</strong></td>
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<td>• preventing settlement default</td>
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A gap between China’s DVP model and the globally-applied DVP practice

- Proprietary and custody businesses are not covered by full margin requirement and third-party custody of settlement funds.
- Lack of linkage between cash and securities settlement.
- Incomplete default management mechanism.
Key Points of DVP Reform
2017 FSAP report recommended that CSDC shall adopt full DVP model.

Introduce a “sellable settlement block” on the receivable securities when the cash balance of settlement participant is insufficient.

- Improve CSDC’s risk prevention ability as a CCP
- Reduce the financial resources collected for settlement
- Improve market efficiency

Link the securities leg with the cash leg by tagging the net receivable securities.

Settlement default disposal covering all types of businesses: brokerage, margin trading, custody, QFII/RQFII and proprietary business.
1. Link the securities leg with the cash leg by tagging at the end of T+0

Net Buying Participants (with)

- SUFFICIENT cash balance
- IN-SUFFICIENT funds position

CSDC will deliver all receivable shares to the buyer’s securities account, and debit the balance of its settlement reserve account while crediting the seller’s reserve account.

CSDC will still deliver the securities to the buyer’s account, but will tag these securities as “sellable settlement block”, and block all the funds in its reserve account.
2. Multi-batch settlement on T+1.

**The tag suggests:**
CSDC still waits to receive the full amount of payable cash from the buyer and the settlement of the tagged securities is yet to be completed.

**Tagged securities can be sold on T+1**
The proceeds thus obtained will be retained in the settlement system to fulfill the previous payment obligations.

**Multi-batch settlement on T+1**
The tags will be removed once the buying participant finishes funds payment.
3. CSDC’s disposal of the tagged shares.

IF settlement participants fail to fulfill their payment obligation on T+1.

• CSDC has the right to change the tag from “sellable settlement block” to “to-be-disposed settlement block”

“To-be-disposed settlement block” suggests:

• the buying participant has defaulted on the cash settlement on T+1
• the tagged shares are not eligible for any kind of business

“To-be-disposed settlement block” will be removed.

• If the buying participant posts sufficient funds on T+2.
• Or CSDC will dispose of the securities on T+3 and beyond
03 Outlook of Post DVP-Reform Times
The DVP reform: a significant milestone in China’s capital market.

- **Aims and Measures**
  - **01**: Improve interim and ex-post settlement risk control measures
  - **02**: Refined management of settlement risks
  - **03**: Investors can follow the current market practices
Boost the two-way opening up of the Chinese capital market.

Chinese capital market is thus expected to be more attractive and competitive worldwide.
FMIs in Global Landscape

"Channeling" the global financial transaction chain

Role Of FMIs

Play a constructive role in preventing systemic risks brought by financial sanctions

No engagement with non-transactional factors or financial sanctions

Prevent settlement failures in cross-border trades
THANKS YOU