SECURITIES MARKET PRACTICE GROUP

SMPG

Settlement of Exchange Traded Funds Creation and Redemption trades in Australia
Market Practice

Issued on behalf of the Australian Market Practice Group

This market practice document will take effect post implementation of SWIFT Standard Release 2012.

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Author:	AU SMPG

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Changes to previous versions			
Version 1.00	Final	Permission granted from the Australian and New Zealand SMPG – Settlement and Reconciliation to publish Settlement of Exchange traded Funds Creation and Redemption trades in Australia.	Removed the use of SETR//SMPG//ETFT in sample message and sequence diagram. Highlighted the front page (*in red italic*) that this MP document will take effect post implementation of Standard Release 2012 (17/11/2012).
Version 0.7	Initial Draft	Feedback from Evelyne Piron	Minor changes to the front cover sheet.
Version 0.6	Initial Draft	Feedback received and updates from Standards Securities working group conference call held on 15/12/11.	New diagram inserted in Appendix A. Incorporated the use of SETR//SMPG//ETFT in sample message. Updated the Sequence diagrams with SETR//SMPG//ETFT.
Version 0.5 NOV 2011	Initial Draft	Feedback received and updates from Lesley Henderson and Suresh Chinnappa	Whole document
Version 0.4 OCT 2011	Initial Draft	Further changes from Lesley Henderson and Suresh Chinnappa	Whole document

Version 0.3 OCT 2011	Initial Draft	Further changes from Lesley Henderson and Suresh Chinnappa	Whole document
Version 0.2 OCT 2011	Initial Draft	Changes resulting from Lesley Henderson's feedback	Whole document
Version 0.1 SEPT 2011	Initial Draft	Initial draft prepared by Suresh Chinnappa	Whole document

I. Scope and definitions:

The scope of this document is to describe a market practice to enable the correct settlement of Exchange Traded Fund (ETF) trades and trades relating to the creation of the ETF in the Australian Clearing House Electronic Sub-register (CHESS) settlement system.

ETF units are created in the primary market in creation unit quantities, which consists of a fixed number of ETF units in exchange for the creation unit portfolio, which is a basket of securities that is equivalent in value to the ETF units that comprise a creation unit. Redemption of ETF units occurs in the opposite way where an investor with a creation unit number of ETF units can apply to the issuer for an unit redemption and receive the creation unit portfolio back.

All stock movements relating to the creation (or redemption) of ETF units in the primary market, including the asset movement of the ETF unit and all the trades that make up the underlying basket in exchange, must be flagged with 'F' in CHESS for settlement, where 'F' is the facility for Non Reportable Transactions, and denotes that transactions are not subject to the Non-Guarantee Fund. This tag is also matching criteria for settlement so is critical. The suggested SWIFT qualifier/code to enable settlement participants to accurately identify these stock movements relating to ETF unit creations and redemptions for correct settlement, is 'SETR/ETFT' and should be populated in Tag 22F of Sequence E: Settlement Details. 'SETR/INSP' is not suitable for this purpose as it relates to a movement of shares into or out of a pooled account, and there are other scenarios of such movements that are not specifically related to ETF unit creation activity so will not be enough to enable the correct tagging of the trades in CHESS. Secondary market ETF unit settlement is out of scope as these are traded on the ASX through Integrated Trading System (ITS) and settled using CHESS just like any other listed financial product.

II. Actors and Roles:

This paragraph describes the roles and actors involved in the process described in the market practice document.

Actors an Roles definitions	
Description	Definition
ETF Issuing Party	Party that issues the ETF units in the primary market.
Instructing Party	Party that instructs the executing/servicing party to process and monitor a transaction. In this case, the Instructing Party is also the ETF Issuing Party and is instructing the Global Custodian.
Authorised Participant	Party that applies to the issuer for ETF Units in the Primary Market. This party will be the other side to the settlement transaction with the sub-custodian.
Global Custodian	The party that holds financial instruments on behalf of another party, and effects asset and cash movements on behalf of this party using the facilities of a settlement agent or sub-custodian. In this case, the Global Custodian is holding the inventory of financial instruments on behalf of the ETF Issuing Party.
Sub-Custodian	The party that is instructed by the Global Custodian to hold their financial instruments within a location or market. The sub-custodian is also the settlement participant within the location or market.

Actors an Roles definitions	
Description	Definition
Sub-register (Clearing House Electronic Sub-register System (CHESS))	An infrastructure that holds or controls the holding of physical or dematerialised financial instruments belonging to all, or a large portion of, the investors in a securities market. Specific to Australia, CHESS is the sub-register which transfers the legal ownership of securities in both the primary and secondary markets between buyers and sellers and transfers money between CHESS participants.

III. Activity Diagram:

For settlement of ETF transaction the below describes typical example of a process flow:

Descriptions of the activities for ETF Creation			
ETF Issuing Party/Instructing Party	Global Custodian	Sub-Custodian	CHESS
Send MT541's to receive in each stock that makes up the creation basket and send a MT543 to deliver the units to the Authorised Participant. MT541/543 will have SETR/ETFT in Tag 22 of Sequence E	Receive swift messages		
	Send instruction to sub-custodian in Australia to settle the creation basket and creation units. MT541/543 will have SETR/ETFT in Tag 22 of Sequence E	Receive and process swift instructions	
		Send transactions to CHESS with the 'F' flag.	Receive transactions and match with counterparty (Authorised participant) based on mandatory matching criteria, including 'F' tag
	Update transactions and send MT545/547 to Instructing party/ETF	Receive settlement confirmation and send swift MT545/547 to	Settle transactions and send confirmation

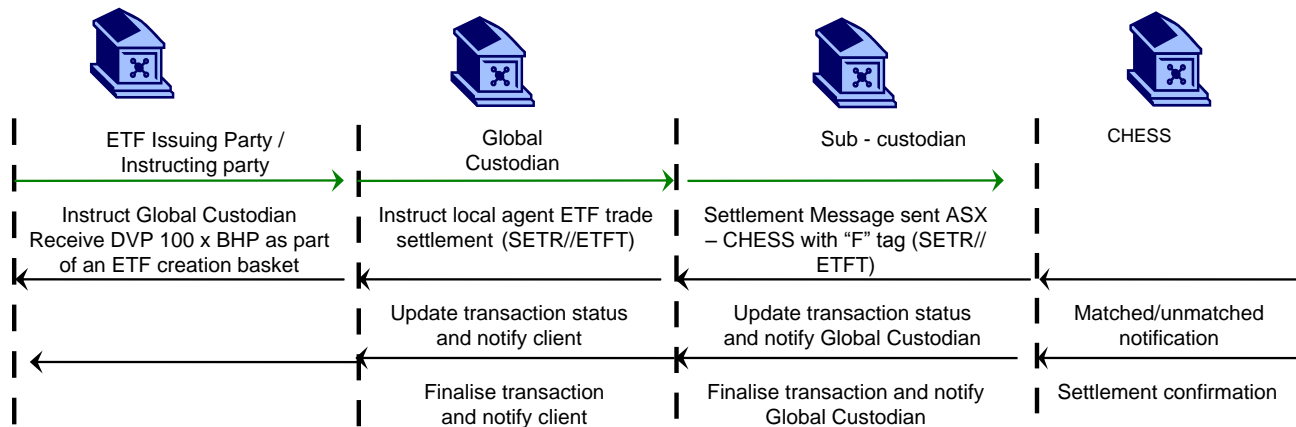| Descriptions of the activities for ETF Creation			
ETF Issuing Party/Instructing Party	**Global Custodian**	**Sub-Custodian**	**CHESS**
	Issuing Party	Global Custodian	

Please refer to the Appendix A for a detailed activity diagram.

IV. <u>Sequence Diagrams:</u>

A sequence diagram describes the high level communication requirements a business process requires. It shows the typical exchanges of Messages in the context of a transaction.

Note that for the same business process, there may be more than two actors/roles involved having different communication requirements.

ETF creation basket
scenario

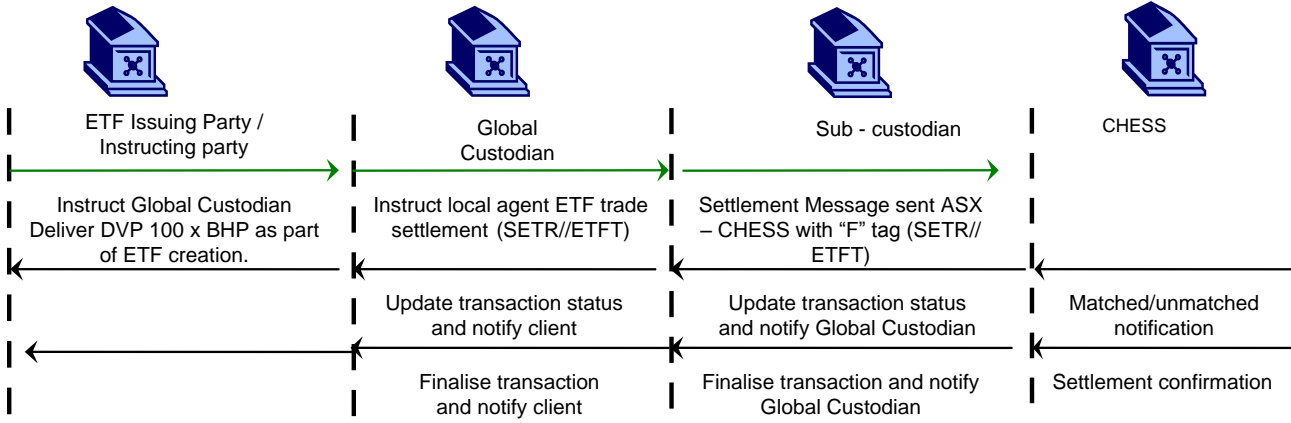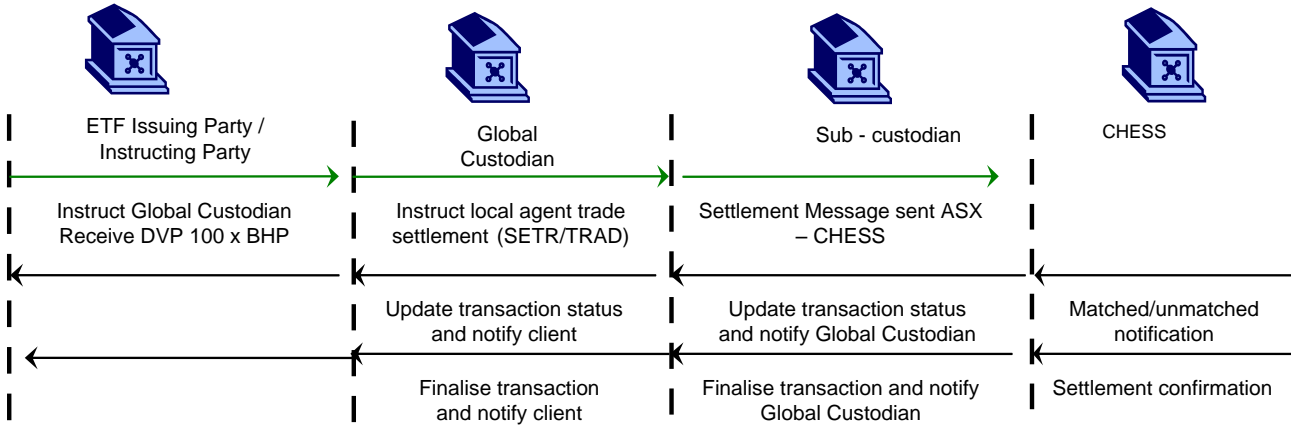| ETF Issuing Party / Instructing party	Global Custodian	Sub - custodian	CHESS
Instruct Global Custodian Receive DVP 100 x BHP as part of an ETF creation basket	Instruct local agent ETF trade settlement (SETR//ETFT)	Settlement Message sent ASX – CHESS with "F" tag (SETR//ETFT)	
	Update transaction status and notify client	Update transaction status and notify Global Custodian	Matched/unmatched notification
	Finalise transaction and notify client	Finalise transaction and notify Global Custodian	Settlement confirmation

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ETF Unit Delivery as part of the ETF creation basket scenario

ETF Issuing Party / Instructing party	Global Custodian	Sub - custodian	CHESS
Instruct Global Custodian Deliver DVP 100 x BHP as part of ETF creation.	Instruct local agent ETF trade settlement (SETR//ETFT)	Settlement Message sent ASX – CHESS with "F" tag (SETR//ETFT)	
	Update transaction status and notify client	Update transaction status and notify Global Custodian	Matched/unmatched notification
	Finalise transaction and notify client	Finalise transaction and notify Global Custodian	Settlement confirmation

Standard Receive DVP scenario

ETF Issuing Party / Instructing Party	Global Custodian	Sub - custodian	CHESS
Instruct Global Custodian Receive DVP 100 x BHP	Instruct local agent trade settlement (SETR/TRAD)	Settlement Message sent ASX – CHESS	
	Update transaction status and notify client	Update transaction status and notify Global Custodian	Matched/unmatched notification
	Finalise transaction and notify client	Finalise transaction and notify Global Custodian	Settlement confirmation

Standard Deliver
DVP scenario
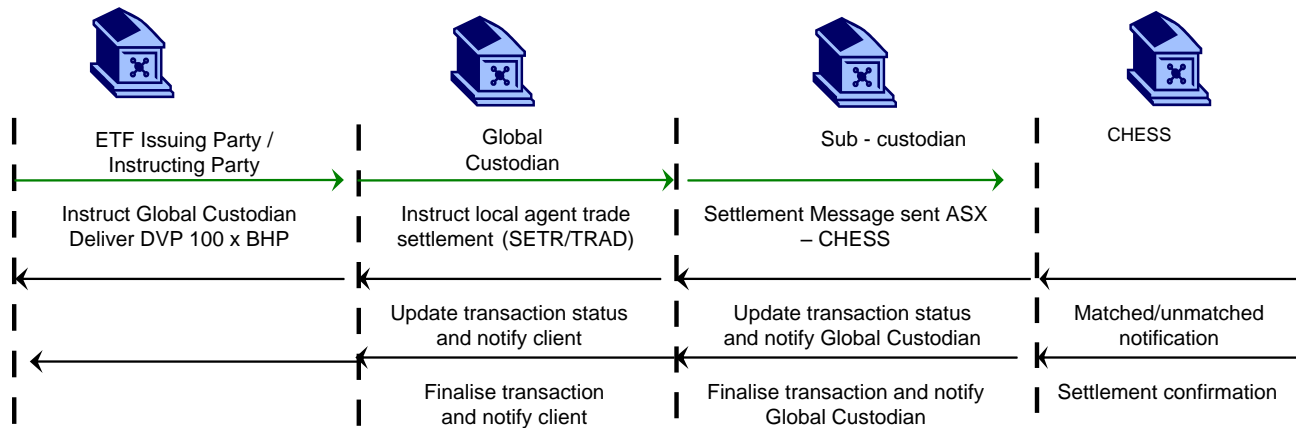
V. Business data requirements:

Business data requirement section describes the business information that will be needed for the business process to take place

EXAMPLE:

For the above-described different communication needs, the following business data are required. Focus is on the processes described in the MP:

A. Instruct settlement:

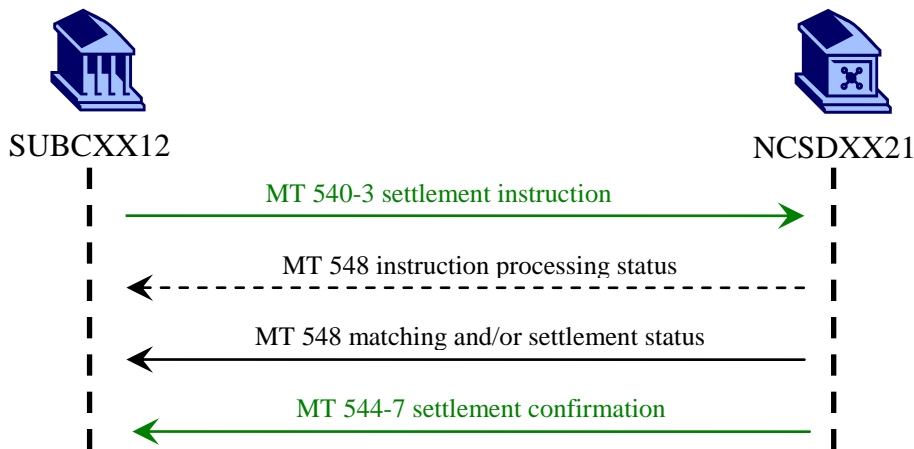| Business elements	Additional information
Message reference	
Trade Date	ISO 8601 Date/Time
Settlement Date	ISO 8601 Date/Time
Quantity of Financial Instrument	Expressed as units
Financial Instrument	ISO 6166 International Securities Identification Number [ISIN]
Settlement Amount	Currency and amount
Safekeeping Account to be credited or debited	
Place of Settlement	ISO 9362 Bank Identifier Codes [BIC] taken from the list of PSET's BIC published on www.smpg.info. See also Place of Settlement MP.
Receiving/Delivering Agent	ISO 9362 Bank Identifier Codes [BIC] or CSD Local Code
Client of Receiving/Delivering Agent	ISO 9362 Bank Identifier Codes [BIC]
Country specifics as per local market practice (if any)	Country specifics as per local market practice (if any)

VI. Market Practice Rules:

When instructing an ETF creation or redemption security transaction for settlement in the Australian market it is necessary for the relative Deliver or Receive instruction be flagged as follows:

- Mandatory Sequence E Settlement Details
- Block 16R SETDET
- Field 22F:Indicator
- Qualifier: SETR – Type of Settlement Transaction Indicator; Specifies underlying information regarding the type of settlement transaction.
- Code – ETFT – Exchange Traded Funds

VII. ISO 15022 illustration:

The ISO 15022 illustrations shows how the MP will be implemented using ISO 15022 messages.

EXAMPLE:

SUBCXX12   NCSDXX21

MT 540-3 settlement instruction

MT 548 instruction processing status

MT 548 matching and/or settlement status

MT 544-7 settlement confirmation

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A. Instruct settlement:

Global Custodian GCUSxx21 send an equity trade settlement instruction to Sub-custodian for settlement in CHESS.

:16R:	GENL	
:20C::	SEME//123456789	Message reference
:23G:	NEWM	
:16S:	GENL	
:16R:	TRADDET	
:98A::	TRAD//20111004	Trade date
:98A::	SETT//20111007	Settlement date
:35B::	ISIN// XX0000ABC123	ISIN
:16S:	TRADDET	
:16R:	FIAC	
:36B::	SETT//UNIT/5000	Quantity
:97A::	SAFE//123456	Safekeeping account
:16S:	FIAC	
:16R:	SETDET	
:22F::	SETR//ETFT	Settlement transaction type
:16R:	SETPRTY	
:95P::	SELL//GLOBCU12	Party
:16S:	SETPRTY	
:16R:	SETPRTY	
:95P::	REAG//SUBBKR12	Receiving agent
:16S:	SETPRTY	
:16R:	SETPRTY	
:95P::	PSET//CAETAU21	Place of settlement
:16S:	SETPRTY	
:16R:	AMT	
:19A::	SETT//AUD500000	Settlement amount
:16R:	AMT	
:16S:	SETDET	

VIII. Appendix A: Activity Diagram