

Tutorial 6 Qn 2

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Content

(a)

What are the settlement models available in the wholesale payment systems? Briefly describe the advantages and disadvantages of each model

(b)

What is CHIPS?
Describe how CHIPS operate?

(c)

In what ways is CHIPS different from the RTGS Fedwire?

What are the settlement models available in the wholesale payment systems? Briefly describe the advantages and disadvantages of each model

Real Time Gross Settlement

- Real Time
- Gross Settlement
- Payments are final and irrevocable

Advantages	Disadvantages
Safe and secure system	Requires more net liquidity
Transfers have no amount cap	
Real time transfer of funds	
Credit and liquidity risks are eliminated	
Flexible movement of funds reduces the systematic risks	

What are the settlement models available in the wholesale payment systems? Briefly describe the advantages and disadvantages of each model

Multilateral Net Settlement Systems

- Transactions be summed
- A single net position is produced for each participant
- Occurs at 1 or more pre-specified times during day
- Finality is achieved upon completion of settlement

Advantages	Disadvantages
Reducing intercompany cash flows	Risk is shared
Simplifying payment schedules	Legal issues: Not all closeout bilateral netting arrangements are recognized by law
Centralizing risk	Cash flow problems can arise when some member companies fail to pay

What are the settlement models available in the wholesale payment systems? Briefly describe the advantages and disadvantages of each model

Hybrid Settlement Systems

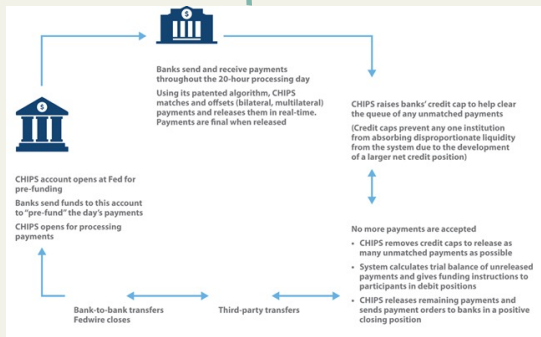
- Combines features of RTGS and Net settlement systems

Advantages	Disadvantages
Less delay for payments settlement than end-of-day netting systems	
Lower the liquidity needs	
Efficiency gains and cost savings can be achieved by consolidating the individual banks' payment streams	
Diminish any bank's incentive to delay its own payments	

What is Clearing House Interbank Payment Systems (CHIPS)

- Private clearing house for large value transactions
- Owned wholly by financial institutions
- Settles over 1.5 trillion USD in about 250,000 transactions daily
- 43 participating banks
- Both a customer and competitor of FedWire
- CHIPS work by netting debits and credits across transactions, provide both clearing and settlement services to its customers banks

Describe how CHIPS operate?



In what ways is CHIPS different from the RTGS Fedwire?

CHIPS (new)	RTGS Fedwire
Privately owned clearing house	Operated by the Federal Reserve (Banks)/ Central Bank
A small group of participants (~50)	Thousands of banking participants
Allows netting of small and less time-sensitive fund transfers using an algorithm to match debits and credits	Real-time grossing of fund transfers
Allows real-time grossing for large sums using a priority system	
Balance cleared to 0 at the end of the day (5:15 pm)	Balance kept in the Fedwire account
Less expensive (charges and funds required)	Capital intensive

