

**NOTICE TO SETTLEMENT ACCOUNTHOLDERS PURSUANT TO CLAUSE 4.1 OF
ESAS TERMS AND CONDITIONS : CHANGES TO SETTLEMENT SUBMISSION
MECHANISM: NEXT DOWN LOOPING, AUTO OFFSET AND FREEZE FRAME**

1 This notice is given by the Reserve Bank of New Zealand (the “**Bank**”) to Settlement Accountholders under clause 4.1 of the ESAS Terms and Conditions. In accordance with that clause, the operation of the Settlement Submission Mechanisms described in this notice shall become effective on 1 September 2006. This notice replaces all previous notices issued under clause 4.1.

2 Capitalised terms which are defined in the ESAS Terms and Conditions have the same meaning where used in this notice.

Next Down Looping

3 All Payment Instructions (whether Authorised Payment Instructions or Unauthorised Payment Instructions) will be recorded in the Payment Instruction Queue and, subject to paragraphs 16-22, tested according to paragraphs 4-7 below.

4 Either: (A) immediately upon Authorisation of a Payment Instruction; or (B) after a period of time determined by the Bank following Authorisation, the System will test for Settlement of the Payment Instructions in the Payment Instruction Queue. The Bank shall determine when Settlement testing shall occur in relation to Authorisation, and must advise Accountholders before any change to that timing comes into effect.

5 If an Authorised Payment Instruction satisfies the Settlement Tests, it will be Settled and will automatically be removed from the Payment Instruction Queue. If an Authorised Payment Instruction fails the Settlement Tests, it (together with any Offsetting Payment Instructions as defined in paragraph 9) will be subjected to further Settlement Tests using the Auto Offset process described in paragraphs 8 to 15. If an Authorised Payment Instruction together with any Offsetting Payment Instructions satisfies the Settlement Tests, the relevant Authorised Payment Instructions and Offsetting Payment Instructions will be Settled and will automatically be removed from the Payment Instruction Queue.

6 Authorised Payment Instructions which do not satisfy the Settlement Tests will remain eligible for settlement and may be re-tested for Settlement in accordance with paragraphs 4 and 5, unless those Authorised Payment Instructions are Settled (before they are re-tested) as a result of applying Auto Offset or Freeze Frame.

- 7 After performing the Settlement Tests on an Authorised Payment Instruction in the manner outlined in paragraphs 4 to 6 above the System will apply the Settlement Tests to the next Authorised Payment Instruction in the same manner. The System will test Authorised Payment Instructions in the order in which they were Authorised and will continue to do so until such time as it has tested all Authorised Payment Instructions which were in the Payment Instruction Queue at the time that the first Authorised Payment Instruction referred to in paragraph 4 above was tested.

Auto Offset

- 8 The Auto Offset Settlement Submission Mechanism (“Auto Offset”, as described in paragraphs 9 to 15) will be applied on a bilateral basis between two Settlement Accountholders. Accountholders will not be able to disable the use of Auto Offset unless advised by the Bank acting in accordance with paragraph 22.
- 9 Under Auto Offset, the System will attempt to Settle the Initiating Payment Instruction simultaneously with one or more Authorised Payment Instructions from the recipient in favour of the initiating Accountholder (“**Offsetting Payment Instructions**”).
- 10 The System will only Settle an Initiating Payment Instruction and one or more Offsetting Payment Instructions if the Settlement Tests are met in respect of both the Initiating Accountholder and Recipient taking into account the Initiating Payment Instruction and all relevant Offsetting Payment Instructions.

Changes to Normal Order of Settlement under Auto Offset

- 11 The Auto Offset process will first test to determine whether the Settlement Tests are satisfied for the Initiating Payment Instruction and the first Offsetting Payment Instruction in the Payment Instruction Queue. The Auto Offset process will successively add additional Offsetting Payment Instructions (if any) in accordance with paragraph 12 in the order in which they have been Authorised and apply the Settlement Tests to the aggregate sum of such Offsetting Payment Instructions.
- 12 If adding an Offsetting Payment Instruction to the Auto Offset process in respect of an Initiating Payment Instruction would cause the aggregate sum of the Offsetting Payment Instructions to fail the Settlement Tests then that Offsetting Payment Instruction will be excluded from the Auto Offset process in respect of that Initiating Payment Instruction, and subsequent Offsetting Payment Instructions will be added to the Auto Offset process

for that Initiating Payment Instruction. This process will continue until one of the following events occurs, whichever is the earliest;

- (a) the Initiating Payment Instruction and the Offsetting Payment Instruction or Offsetting Payment Instructions all satisfy the Settlement Tests, in which event the Initiating Payment Instruction and the relevant Offsetting Payment Instructions are Settled and automatically removed from the Payment Instruction Queue:
 - (b) for the relevant Initiating Payment Instruction, the System has performed the Settlement Tests in respect of the maximum number of Offsetting Payment Instructions determined by the Bank or there are no further Offsetting Payment Instructions in the Payment Instruction Queue and the Settlement Tests have not been satisfied, in which event the relevant Initiating Payment Instruction will remain in the Payment Instruction Queue and the System will attempt to Settle the next Authorised Payment Instruction in the Payment Instruction Queue.
- 13 As a consequence of the Auto Offset process set out in paragraphs 11 and 12, it is possible that a Payment Instruction which is Authorised after other Authorised Payment Instructions may be Settled by the System before those earlier Authorised Payment Instructions.
- 14 The Bank may determine at any time the maximum number of Offsetting Payment Instructions which may be tested simultaneously with an Initiating Payment Instruction and must advise Members of that maximum number before it comes into effect.
- 15 When Auto Offset applies, the Settlement Accountholder acknowledges that when an Authorised Payment Instruction is recorded in the Payment Instruction Queue, it is immediately available for Auto Offset with the Recipient Authorised Payment Instructions in favour of that Settlement Accountholder.

Freeze Frame

- 16 For the purposes of paragraphs 16 to 20 a reference to:
- 16.1 “Authorised Payment Instruction” is a reference to all Authorised Payment Instructions which the Accountholder and each other Settlement Accountholder has specified are eligible for Settlement by Freeze Frame;

- 16.2 “Settlement Account” means the Settlement Accounts of the Accountholder and each other Settlement Accountholder in respect of which the Freeze Frame mechanism has attempted, or will attempt, to Settle Authorised Payment Instructions.
- 17 The Freeze Frame settlement submission mechanism may only be initiated by the Reserve Bank. The Freeze Frame settlement submission mechanism may be set by the Reserve Bank to operate on an automatic re-occurring basis at predetermined intervals during and at the end of the ESAS Day or may also be operated by the Reserve Bank at any time when it thinks appropriate (eg when larger than usual volumes are submitted and/or gridlock occurs).
- 18 Upon initiation of Freeze Frame, the System will attempt to Settle all unsettled Authorised Payment Instructions in the Payment Instruction Queue which the relevant Accountholder has indicated in the relevant Authorised Payment Instruction are eligible for Settlement by Freeze Frame.
- 19 If Settlement of all the Authorised Payment Instructions in the Freeze Frame mechanism would result in the balance in each Settlement Account being equal to or more than its Minimum Account Balance, the Freeze Frame mechanism will Settle all those Authorised Payment Instructions.
- 20 If Settlement of all the Authorised Payment Instructions held in the Freeze Frame mechanism would result in the balance of one or more Settlement Accounts being below the Minimum Account Balance, Freeze Frame will not Settle any of those Authorised Payment Instructions.

Further Changes to Settlement Submission Mechanisms

- 21 Subject to paragraph 22 it is acknowledged that the Bank may only change the operation of the Settlement Submission Mechanisms (as described above) after prior consultation by the Bank with all Settlement Accountholders, in accordance with Schedule B of the ESAS Terms and Conditions.

Temporary Suspension of the Settlement Submission Mechanisms

- 22 Notwithstanding paragraph 21, the Bank may temporarily suspend the operation of the Settlement Submission Mechanisms in accordance with clauses 4.7 and 4.8 of the ESAS Terms and Conditions.