



15 August 2008

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Personal Property Securities  
Australian Attorney-General's Department  
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**BY MAIL & EMAIL**

Dear Sir/Madam

**Submission on Consultation Draft of the Personal Property Securities Bill 2008**

Thank you for the opportunity to comment on the Consultation Draft of the Personal Property Securities Bill (PPS Bill).

We set out below our comments on the PPS Bill in relation to investment instruments (eg shares, interests in managed investment schemes, debentures, stocks or bonds issued by a government, derivatives etc).

**1. Background**

**About Computershare**

Computershare Limited together with its related bodies corporate is a global leader in securities registration, employee equity plans and other specialised financial and communication services. Many of the world's largest corporations employ our innovative solutions to maximise the value of their relationships with investors, employees, customers and members.

One of our businesses, Computershare Investor Services Pty Limited, principally establishes and maintains registers of security holders for companies and registered managed investment schemes in accordance with the Corporations Act 2001 (Corporations Act). Generally these entities are listed on the Australian Securities Exchange. The registry function includes the recording of the details of registered security holders – notably their name, address and holding balance.

**2. Regulations to exclude investment instruments from the PPS Bill**

We note that the Commentary to the PPS Bill at 3.10 states that:

*"It is likely that the regulations would exclude lending arrangements in relation to investment instruments from the definition of security interest."*

We have already expressed strong support for the exclusion of investment instruments from the PPS Bill for the reasons set out in our 8 February 2008 submission (copy attached).

The statement in the Commentary sits at odds with the treatment in the PPS Bill of security interests affecting investment instruments. If the intention is as expressed in the Commentary rather than the Bill, it might be clearer, rather than excluding investment instruments from the definition of security interest by regulation that they be excluded from the definition of "security interest" in section 21 of the PPS Bill. Alternatively, investment Instruments could be added to the list of items that the Act does not cover in section 22.

### **3. If PPS Bill is to apply to investment instruments**

The following observations are made on the basis that, the statement in the Commentary notwithstanding, the PPS Bill is in fact intended to cover security interests in respect of investment instruments.

#### ***3.1 Clear guidance in Commentary required on how PPS Bill should apply to investment instruments***

It is critical that the securities industry is clear on how the PPS Bill is intended to work in relation to investment instruments. This is especially the case if PPS legislation covering investment instruments encourages new lending practices in relation to investment instruments.

We note that the Government's June 2008 Green Paper on Financial Services and Credit Reform notes at page 29 that *"... with the stock market moving into a time of more uncertain growth, there has been some recent concern surrounding retail clients' understanding of how their margin loan product operates."*

If the PPS Bill is to apply to investment instruments it is important that it operate as a replacement of the current provisions contained in the Corporations Act and consistently with market practice that has evolved, particularly since the creation of the concept of paperless securities and paperless securities transfers, for the taking of security over investment instruments.

We note that the Commentary does not have clear guidance on how the proposed legislation is intended to apply to investment instruments in practice. We suggest the Commentary contains some worked examples – for example, a discussion of the usual means of immobilising CHES securities as currently contemplated by s262(1)(g)(iii) of the Corporations Act. This will give the grantor, secured party, issuers, brokers, registrars and others in the securities industry clarity on how the legislation is intended to work in practice.

An important consideration in this context will be to ensure that security provision over investment instruments is a matter between the grantor and security provider, and does not involve issuers of securities or their registries. Involvement of issuers in private security arrangements will detract significantly from current market efficiencies, which are world class. It is important that best in class efficiency is maintained to ensure the ongoing competitiveness of Australia's financial markets.

#### ***3.2 Control of certificated investment instrument***

We suggest the drafting in section 34(1)(b) which deals with control of a certificated investment instrument is amended so it is clear who the "other person, (as the case requires)" could be.

**3.3 Default – making payments owed on investment instrument to secured party – exclude investment instruments**

We note that under section 168(1) and (2) if an investment instrument provides an obligation to pay the grantor and the grantor defaults, the secured party may do either or both of the following:

- (a) give a written notice to ***any person obligated on the collateral requiring the person to discharge the secured obligation;***
- (b) seize any proceeds of the collateral to which the secured party is entitled.

Under section 168(3) ***a person who receives a notice must pay to the secured party any amount that the person owes to the grantor within 5 business days of the later of:***

- (a) the day the notice is received; or***
- (b) the day the amount becomes due and payable.***

We believe that this clause will impose an unnecessary and unworkable obligation on issuers if it is intended to apply to dividends/distribution payments on investment instruments.

We strongly recommend that investment instruments that provide an obligation to pay the grantor be excluded from section 168. This is particularly the case with shares and registered interests.

This is because it will be difficult to make this work in practice given that large number of distributions made by issuers. The compliance costs for issuers will far outweigh the funds retrieved by the secured party given that usually distributions are for quite small amounts.

In Australia during the 2006/2007 financial we made approximately 857 payments comprising 1.7 million cheques and 11.7 million direct credits. In addition, approximately 7,800 fixed interest payments were made. In addition there are other registrars in Australia who would also have made a significant number of payments.

The issuers' obligation to make a distribution to a person such as a dividend only arises when the dividend is declared by the issuer or the payment date for a dividend authorised by the issuer occurs.

In each case the person must hold the shares on the record date, whether or not the person continues to hold the shares (or any of them) on the payment date. Accordingly, the notice would have to be provided by the secured party to the issuer after each dividend. The issuer would have to record the secured party's bank account on the holding (or record the secured party's address on the holding in order to pay by cheque) and then remove the secured party's details immediately after the payment and reinstate the holder's payment details.

This process would necessarily be a manual process which would be costly and time consuming to perform. In addition, there is a risk errors will be made resulting in distributions being paid to the wrong bank account.

We note that under section 169(5) a secured party must give written notice to the grantor of any action taken under section 168(2) ***within 5 business days after the action is taken.*** Accordingly,

there is a very high likelihood of the grantor calling the issuer (or their registrar) to enquire why their distribution was not paid either by cheque or into their bank account. We find that holders are well aware when to expect payments to be made into their bank accounts and can they often plan to use those amounts for on the day received.

Accordingly, investment instruments should be excluded from section 168. If a secured party wishes to receive distributions they should simply structure their security arrangements accordingly, by being, or having their nominee, registered as the holder of the investment instruments.

***3.4 Default - secured party seizing collateral – secured party acts as agent to reflect the transfer of title on books or registers that evidence title to the collateral***

Where the grantor defaults we note that if the secured party has perfected a security interest in collateral by possession or control (or by any other method) and the secured party gives a notice to the grantor then the secured party is taken to have seized the collateral (sections 170 and 171).

The secured party may dispose of the collateral (section 175) or retain the collateral (section 181).

Section 188 states that:

***"A secured party who is entitled to dispose of, or retain, collateral under section 175 or section 181 may take any steps necessary, as agent for the grantor, to reflect the transfer of title resulting from the disposal or retention on any books or registers that evidence title to the collateral."***

We suggest that section 188 be amended to clearly state that the secured party who is entitled to dispose or retain collateral is taken by force of the section to be appointed the grantor's agent.

This is because the issuer and its registrar need to be certain it is legally entitled to take instructions from the secured party and amend the register. Currently the legal ownership of investment instruments are only transferred on instructions from the legal holder or their attorney – a certified true copy of the power of attorney is sighted before instructions from the attorney are acted upon.

The consequences of transferring the legal ownership of investment instruments without authority has serious implications for the issuer and their registrar.

For example, section 175(1) of the Corporations Act provides that the company or registered scheme or a person aggrieved may apply to the court to have the register corrected. If the Court orders the company or scheme to correct the register it may also order the company or scheme to compensate a party to the application for loss or damage suffered (section 175(2)).

In the case of shares held on an issuer's issuer sponsored sub-register, where the secured party lodges an off market transfer form to transfer the shares as agent to the secured party or other party an explanation of the circumstances will have to accompany the off market transfer form. This is because instructions are only taken from the legal holder of the shares or their attorney. Section 1071B(2) provides that the company must only register a transfer of securities if a proper instrument of transfer has been delivered to the company (failure to comply with this subsection is an offence under section 1311(1) of the Corporations Act).

On current drafting of the PPS Bill it seems that the issuer and their registrar will have to look behind the arrangement to ensure that the secured party can as a matter of fact (rather than by force of law) act as agent before the off market transfer form is processed.

The types of matters the issuer and their registrar would have to address will include:

- does the secured party have an entitlement to dispose or retain collateral under section 175 or section 181 ie has the grantor been given a seizure notice?
- is there a higher priority interest which has given the secured party notice of that interest under section 174?

Given that it is likely that investment instruments will become a common form of security and given the large number of holders on a register, this will be a time consuming and expensive task for the issuer and their registrar.

Accordingly, we suggest that detailed consideration be given to the following.

1. The secured party being required to provide the issuer with a notice in a prescribed form and a copy of the seizure notice provided to the grantor to confirm that it is by force of the section acting as agent (this would be akin to a holder appointing a power of attorney in which case the issuer requests to sight the power of attorney before acting on instructions of the attorney).
2. The PPS Bill providing that if the issuer and its registrar act in good faith based on information provided by the secured party then no action can be taken by the grantor or any other party (eg a buyer) against the issuer or their registrar under the Corporations Act.

### ***3.5 Extent to which the Bill should implement rules consistent with the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary***

We see that the Bill includes governing laws that are specific to a security interest in an "investment entitlement" (section 50).

Section 50(7) defines an "investment entitlement" as follows.

*"investment entitlement means an interest in any of the following financial products that is evidenced by registering the person who owns the interest on books maintained for that purpose by or on behalf of a securities intermediary:*

*(a) any of the financial products mentioned in paragraphs (a) to (e) and (g) of the definition of investment instrument other than:*

*(i) a security interest; or*

*(ii) a financial product of a kind prescribed by the regulations for the purpose of this definition;*

*(b) any other financial product (whether or not the product is a quoted security) prescribed by the regulations for the purpose of this definition."*

We understand from the Commentary at 11.71 that these governing law rules are derived from the Hague Convention on the Law Applicable to Certain Rights in Respect of Securities Held with an Intermediary (the Convention) and that during the consultation period consideration will be given to the extent to which the Bill should implement rules consistent with the Convention.

It seems that the purpose of the Convention is to provide certainty as to what law applies to certain issues in respect of securities that cross national borders held with an intermediary such as a clearing and settlement facility or broker. The Convention does not affect the substantive law that applies once the conflict of laws determination has been made.

We note that the text of the Convention was adopted on 13 December 2002 but has not come into force as the only Member States to sign the Convention are the USA and Switzerland (three Member States must lodge an instrument of ratification, acceptance, approval or accession before it comes into force). While Mauritius has signed the Convention, Mauritius is a non-Member State.

We submit that the Bill should not implement rules consistent with the Convention for the following reasons.

- The Convention has not entered into force which may be a reflection of the fact that the Convention is not workable from a practical perspective. We suggest that Australia does not look at bringing in rules consistent with the Convention until other Member states comply with the Convention.
- Article 2 of the Convention sets out the issues falling within the scope of the Convention. It is acknowledged in the Commentary at 11.72 that the Bill does not address a number of issues covered by the Convention which would mean that even if the Bill retained the concept of a security interest in investment entitlements Australia would not be compliant with the Convention. If Australia wanted to implement rules consistent with the Convention we submit that this should not be done in a piecemeal approach with some rules in the PPS Bill and remaining rules in other legislation.
- Introducing the concept of a security interest in an investment entitlement in Division 7 which deals with governing laws adds an extra layer of complexity to the PPS Bill. It is difficult to determine how the concept of a securities interest in an investment entitlement ties in (if at all) with the concept of a securities interest in an investment instrument. Both concepts seem to overlap. We note the definition of "investment entitlement" excludes a security interest – an investment instrument appears to fall into the definition of security interest which would mean it is excluded from the definition of investment entitlement.

If it is decided to retain the concept of a security interest in an investment entitlement in the PPS Bill we submit that the following amendments to the PPS Bill should be made.

- It is made clear in the definition of "securities intermediary" that an issuer of securities or the issuer's registrar is not a securities intermediary. This would be consistent with Article 2 paragraph 3 of the Convention which makes it clear that the Convention does not determine the law applicable to the issuer of securities or of an issuer's registrar or transfer agent.

- It is made clear in the Bill and Commentary in what way a security interest in an investment entitlement is the same or different to a securities interest in an investment instrument.

### **3.6 Liens**

We note that section 22(b) provides that the PPS Bill does not apply to:

*"(b) a lien, charge, or any other interest in personal property (but without limiting the effect of section 112), that is created under any of the following:*

*(i) an Act of the Commonwealth (other than this Act), a State or Territory, or an instrument made under such an Act;*

*(ii) a rule of law (but not a rule of equity);"*

We noted in our 8 February 2008 submission we suggest that the PPS legislation should also not apply to liens created under the constitutions of Issuers (eg in relation to partly paid securities).

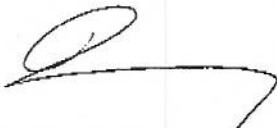
### **3.7 Definition of "investment instrument"**

We suggest that the definition of "investment instrument" be amended to include the name of the relevant Act referred to in item (b) which currently reads: *"(b) interests in a registered scheme (within the meaning of that Act);"*

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We would be happy to discuss any matter raised in this submission. Please contact me by email ([dominic.horsley@computershare.com.au](mailto:dominic.horsley@computershare.com.au)) or telephone (Ph 03 9415 5162).

Yours faithfully



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