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No. 80 2001–02

**Commonwealth Inscribed Stock Amendment Bill  
2002**

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Commonwealth Inscribed Stock Amendment Bill 2002

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Law and Bills Digest Group  
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# Commonwealth Inscribed Stock Amendment Bill 2002

**Date Introduced:** 14 February 2002

**House:** House of Representatives

**Portfolio:** Treasury

**Commencement:** The substantive provisions of this Bill commence on Proclamation or alternatively within 6 months of Royal Assent.

## Purpose

To provide for:

- the electronic creation, issue, recording and transfer of Commonwealth Government Securities (CGS)
- the electronic transfer of Commonwealth Government Securities by clearing and settlement facilities under the *Corporations Act 2001*
- the creation of equitable interests in CGS
- the electronic transfer of legal or equitable interests in CGS in accordance with regulations made under the *Commonwealth Inscribed Stock Act 1911* (CIS Act), or by applying provisions of the *Corporations Act*, and
- the appointment of non-government clearing and settlement facilities regulated under the Corporations Act as Registrars under the CIS Act in addition to, or instead of, the Reserve Bank of Australia (RBA).

## Background

This Bill is essentially identical to the Commonwealth Inscribed Stock Amendment Bill 2001 which was introduced into the House of Representatives on 23 August 2001. That Bill was passed by the House on 19 September and was then referred by the Senate to the Economics Legislation Committee. The Bill lapsed when Parliament was prorogued for

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the 2001 General Election. Nevertheless, the Committee continued with its inquiry and unanimously endorsed the Bill in its report released on 6 December 2001.<sup>1</sup>

Recent reforms to corporate law have gone some way towards recognising that Commonwealth law has at times failed to take account of the extent and speed of technological innovation in modern commercial practices. It is frequently alleged that the law is out of touch with the needs of contemporary business operations. The Corporate Law Economic Reform Program Report No. 5 stated:

The increasing internationalisation of markets and economies highlights the need to ensure that policies maximise the competitiveness and efficiency of the domestic economy. Australia's laws must provide the development of systems and market practices that will reduce legal uncertainty and transaction costs, and increase trading efficiency. This will, in turn, facilitate the competitiveness of Australia's markets in the global trading environment.<sup>2</sup>

The introduction of this Bill takes place against a general background of much recent corporate law reform activity, as well as reform of legislation applicable to electronic commerce. This has included the *Corporate Law Economic Reform Program Act 1999*, *Electronic Transactions Act 1999* and the *Financial Services Reform Act 2001*. The latter Act makes provision for a streamlined regulatory regime for financial markets and clearing and settlement facilities, through amendments to the *Corporations Act 2001*.

## Reason for the Bill

The issue and trade of Commonwealth government securities is regulated by the *Commonwealth Inscribed Stock Act 1911*.<sup>3</sup> In summary, the Act is outdated legislation - to the extent to which it fails to take account of modern realities, such as electronic trading of securities. The Act does not acknowledge the fact that Commonwealth securities are already traded electronically, and have been so since 1991, with the introduction of the RITS system (*see*: below). An indication of the antiquity of the Act is the fact that it provides: "The Treasurer may establish a Registry for the inscription of stock at London in the United Kingdom" (s.14(b)).

A primary objective of the Bill is to increase the flexibility of options for trading in Commonwealth government securities. The Bill provides for the electronic creation, issue, recording and transfer of Commonwealth Government Securities (CGS). Furthermore, it will facilitate competition in the provision of clearing and settlement<sup>4</sup> facilities for CGS by allowing the appointment of non-government bodies as Registrars under the CIS Act in addition to, or instead of, the Reserve Bank of Australia.

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## Background on Commonwealth government securities

Commonwealth government securities are debt instruments (Treasury Bonds, and Treasury Notes) issued by the Commonwealth government. These devices are issued by the Commonwealth through the Registries of the Reserve Bank.

The raising, management and retiring of Commonwealth debt is overseen by the Australian Office of Financial Management (AOFM) which was established in July 1999 by the *Financial Management and Accountability Act 1997*. The AOFM is required to achieve these objectives at the lowest possible long-term cost, consistent with an acceptable degree of risk exposure.

The trade in Commonwealth securities is an important aspect of monetary policy. According to the Reserve Bank:

Since the mid 1980s, the RBA has been implementing monetary policy through domestic market operations, rather than using direct controls on banks as was previously the case. The basic nature of these operations has not changed over the intervening period: in essence they involve either sales of securities to reduce the amount of funds in the money market (and so cause interest rates to rise) or purchases of securities to produce the opposite effect.<sup>5</sup>

At 30 June 2000, the total face value of net CGS on issue for the Commonwealth was \$74.4 billion or 11.8% of nominal GDP. At 30 June 1999, the level of debt was \$83.5 billion or 14.0% of nominal GDP. The value of daily bond market turnover in CGS is approximately \$3 billion.<sup>6</sup>

Treasury Notes are short term discount securities with maturities of 13 and 26 weeks issued by the Reserve Bank on behalf of the Commonwealth government. Treasury Notes are issued by competitive tender at regular intervals, usually weekly. Treasury Notes are used by the Commonwealth in order to borrow short term funds from the money market. The issue of bonds does not imply a budget deficit. This borrowing is necessary because the day-to-day timing of Commonwealth receipts does not match the pattern of its outlays. By targeting the maturity of short term borrowings to projected periods of cash surplus, the Commonwealth can achieve the management of its cash balances.

Treasury Bonds include Treasury fixed coupon bonds, Treasury adjustable rate bonds, and Treasury indexed bonds. Treasury Bonds are medium to long-term coupon securities issued by way of inscribed stock. (Inscribed stock is a term used to refer to securities, title to which is recorded in a register, rather than acknowledged by the issue of a certificate of ownership.) The Reserve Bank manages registries of inscribed stock at its branches.

Bonds are usually fixed interest securities upon which interest is paid at regular intervals. Treasury Bonds are of various maturities and are also issued to the market by competitive tender. Institutions who wish to make a tender bid must be registered with the Reserve Bank or use registered bidders as agents. Treasury Bonds are the major debt instrument

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currently issued by the Commonwealth. Treasury indexed Bonds only play a minor role in Commonwealth debt issuance. During the financial year 2001-2002, the Australian Office of Financial Management is planning issuance of between \$2 billion and \$3 billion of Treasury fixed coupon Bonds, and \$200 million of Treasury indexed bonds.<sup>7</sup>

### The Reserve Bank Information and Transfer System (RITS)

The CIS Act, as it stands, does not make provision for the electronic settlement of CGS transactions. It only provides for transactions and transfers of legal title in CGS to be settled by means of a paper based system. In the 1980s this began to cause difficulties for the Reserve Bank as the operator of the Registry for CGS. The Registry was unable to maintain a timely record of title due to the large increase in the volume of CGS transactions

In 1991, the RBA established a separate electronic settlement facility – RITS. The operation of RITS is not specifically provided for in legislation. In its submission to the Senate Economics Committee, the Reserve Bank explained that RITS enabled the restriction on paper-based transfer of CGS within the Registry to be ‘overcome’:

Market participants who want to settle their transactions in CGS electronically transfer their holdings into a pooled account held in the name of the Reserve Bank at the Registry. The Reserve Bank issues legal claims [a chose in action] against holdings into that pooled account, which market participants are then able to trade in RITS ie as far as the registry is concerned, the stock remains in the name of the Reserve Bank while RITS maintains a separate record of claims by individual members over the CGS in the pooled account.<sup>8</sup>

By virtue of electronic processing, RITS allows Commonwealth Government Securities to be transferred and settled simultaneously (on a ‘delivery versus payment’ basis), in real-time. The RITS system also provides automatic interest and maturity payments for securities lodged in the system. According to the RBA: ‘Over 99 per cent of CGS turnover in the market is handled by RITS and securities with a face value of \$64 billion are lodged in the system. There are 136 members of the system representing 248 organisations.’<sup>9</sup>

Members of RITS include all the banks and other major traders of CGS. Non-bank members (other than credit unions and building societies) must have a member bank take responsibility for their payments. Credit unions and building societies may use their special service provider member.<sup>10</sup> Inactive investors hold around 8 per cent of CGS on issue, these investors still settle through the Registry rather than RITS.<sup>11</sup>

Thus while the CIS Act has not presented any legal obstacles to the establishment and use of an electronic system for the transfer of beneficial interests in CGS that system is only open to wholesale market participants.

In 1997, the Government released a paper entitled ‘Electronic Commerce: Cutting Cybertape -Building Business’ as part of the Corporate Law Economic Reform Program.<sup>12</sup>

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Amongst other measures the paper proposed the amendment of the CIS Act to allow electronic transfer of the direct beneficial and legal interests in Commonwealth securities rather than through the legal device of the chose in action used in RITS.<sup>13</sup>

The Bill implements that proposal and may allow investors who do not participate in RITS to participate in electronic trading of CGS. As the Minister noted in his second reading speech:

This Bill will create the potential for retail investors to gain the same access to the risk-free, secure investment product that Commonwealth Government Securities represent, that is currently enjoyed by institutional investors.<sup>14</sup>

## Main Provisions

**Item 2** proposes the insertion of the term ‘clearing and settlement facility’ into section 3 of the CIS Act. That term is defined as a clearing and settlement facility for the purposes of Chapter 7 of the *Corporations Act 2001*.

**Item 4** proposes a new definition of ‘stock’, to take account of changes proposed in this Bill.

**Item 8** proposes additions to section 7 of the *CIS Act* to enable stock to be issued by electronic means, and issued to a person (including a registrar) on trust for other persons. These changes will remove doubt that the Commonwealth can create equitable interests in relation to CGS.

**Item 12** inserts new subsection 14(2) which will enable any person to be appointed by the Treasurer as a Registrar under the Act. As proposed this will include other clearing and settlement facilities regulated under the *Corporations Act*.

**Item 14** inserts new subsection 15 (2) which will provide that a stock ledger may be kept in electronic form.

**Item 19** inserts new subsection 24(1) which provides that regulations may be made to enable the transfer of legal or equitable interests in stock from one person to another.

**Item 20** inserts new section 24A. It provides that where a clearing facility is appointed as a registrar, legal and equitable interests inscribed in a ledger kept by that facility can be transferred according to the rules of the facility as governed by the *Corporations Act 2001*.

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## Concluding Comments

While the Bill will permit competition in the provision of settlement services for CGS it seems unlikely that this will occur in practice. The Senate Economics Committee reported that the RBA is in the process of transferring its role in the settlement of CGS through RITS to Austraclear. Austraclear already provides a settlement system for private sector and State Government debt securities. According to the RBA, this transfer has the ‘strong support of market participants, as it will allow them to lower their cost; in future they will need to maintain access to only one system to settle trades on all their debt securities.’<sup>15</sup>

Although this transfer will see the RBA largely withdraw from a role in settling CGS, under Part 7.3 of the Corporations Act, the Reserve Bank retains responsibility for the regulatory oversight of clearing and settlement facilities. It may determine standards to ensure that such facilities operate in a way which causes or promotes overall stability in the financial system. The RBA is required to assess compliance with these standards at least once a year.<sup>16</sup>

The RBA will still provide registry services to holders of CGS who are not in RITS. These services encompass the issue, transfer and registration of securities, the maintenance of ownership records, the distribution of periodical interest payments and the redemption of securities at maturity. The RBA has indicated that it will continue to provide registry services for as long as the Commonwealth requires it to do so.<sup>17</sup>

## Endnotes

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- 1 Senate Economics Legislation Committee, Commonwealth Incribed Stock Amendment Bill 2001, December 2001. The report is located at the following link: [http://www.aph.gov.au/senate/committee/economics\\_ctte/stock\\_amendbill01/stock\\_amendbill01\\_report.pdf](http://www.aph.gov.au/senate/committee/economics_ctte/stock_amendbill01/stock_amendbill01_report.pdf)
- 2 Commonwealth of Australia (1997), *Electronic Commerce: Cutting Cybertape -Building Business*, Report No 5 of the Corporate Law Economic Reform Programme, AGPS, Canberra, p. 5.
- 3 Note that the Commonwealth has crown immunity from the obligations of the Corporations Law in respect of debt issues.
- 4 Settlement is a process whereby parties meet obligations to each other that arise from entering into the transactions. It includes transfer of ownership and payment.
- 5 Reserve Bank of Australia (2001) *Annual Report 2001*, p.5.
- 6 Peter McCray, Deputy Chief Executive Officer, Australian Office of Financial Management (2000) “The Australian Government Bond Market”, Paper presented to the Asian

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Development Bank Conference on Government Bond Markets and Financial Sector  
Development in Developing Asian Economies, 28-30 March 2000, Manila, Philippines.

- 7 AOFM, Media release, 29 June 2001.
- 8 Reserve Bank of Australia, Submission to Senate Economics Legislation Committee, 16 November 2001, p. 2.
- 9 RBA, Annual Report 2001, p. 42.
- 10 <http://www.apca.com.au/Paymentinstruments.htm> (Australian Payments Clearing Association Limited)
- 11 Reserve Bank of Australia, Submission to Senate Economics Legislation Committee, 16 November 2001, p. 2.
- 12 This paper is also known as CLERP 5.
- 13 Commonwealth of Australia (1997), *Electronic Commerce: Cutting Cybertape -Building Business*, Report No 5 of the Corporate Law Economic Reform Programme, AGPS, Canberra, p. 50.
- 14 The Hon. Peter Slipper, Second Reading Speech, House of Representatives, *Hansard*, 14/02/2002, p. 140.
- 15 Reserve Bank of Australia, Submission to Senate Economics Legislation Committee, 16 November 2001, p. 2.
- 16 See Corporations Act 2001 section 823CA.
- 17 RBA, Annual Report 2001, p. 42.

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