

Parliament of the Commonwealth of Australia

SENATE ECONOMICS LEGISLATION COMMITTEE

**CONSIDERATION OF LEGISLATION REFERRED TO
THE COMMITTEE**

**COMMONWEALTH INSCRIBED STOCK
AMENDMENT BILL 2001**

December 2001

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REPORT

Reference of Bill to the Committee

1.1 The Commonwealth Inscribed Stock Amendment Bill 2001 was introduced into the House of Representatives on 23 August 2001 and passed by that chamber on 19 September 2001. Following a report by the Selection of Bills Committee, the Senate referred the provisions of the Bill to this Committee on 19 September for examination and report by 6 December 2001.

The Committee's Inquiry

1.2 The Committee wrote to a number of interested parties inviting them to make submissions on the Bill, in addition to advertising the inquiry on the Parliament website and issuing a media release. The Committee received three submissions from the following:

- Australian Stock Exchange
- Reserve Bank of Australia, and
- Australian Office of Financial Management.

1.3 The Committee thanks all those who prepared submissions. The Committee also acknowledges the Department of Treasury's offer to attend a public hearing to give evidence but regrets that the Department was not able to provide a written submission to the Committee.

The Bill

1.4 The main aim of the Bill is to establish a legal framework that will make the transfer of Commonwealth Government Securities (CGS) more flexible and allow the market to operate more efficiently and in an innovative fashion.

1.5 In particular, the Bill amends the *Commonwealth Inscribed Stock Act 1911* (CIS Act) to enable the issue and transfer of CGS by electronic means. This will overcome the current restriction in the CIS Act which limits CGS to paper based transfers.

1.6 The Bill also amends the CIS Act to enable:

- the Commonwealth to create equitable interests in Commonwealth Government Securities; and
- the appointment of non-government clearing and settlement facilities or other incorporated company regulated under the Corporations Act as Registrars under the CIS Act instead of, or in addition to, the Reserve Bank of Australia.¹

¹ Explanatory Memorandum, p.3.

Overview of evidence

1.7 All three bodies that made submissions to the Committee supported the amendments proposed under the Bill. The changes that the Bill will introduce are seen as addressing outmoded and cumbersome elements of the current CGS system, particularly the paper based transfer regime for CGS.

1.8 In reference to the new provision for electronic CGS transfers, the Australian Stock Exchange (ASX) stated:

This legislative amendment brings the trading and settlement of CGS into accord with similar securities in the world's most active markets. While Australia is regarded as one of the most sophisticated markets in the world the manner in which the transfer of CGS has been conducted is seriously out of step with comparable markets throughout the world. ASX believes that together with *Financial Services Reform Act 2001*, the amendments to the CIS Act will promote efficiency and confidence in the broader operation of the financial markets.²

1.9 The ASX also highlighted the importance for investors, particularly retired investors, in having, at a time of market volatility, ready access to the type of risk free, secure investment products – ‘the safest product in the country’ – that CGS represent.³ The Bill will provide retail investors with the same access to CGS currently enjoyed by institutional investors.

1.10 The Reserve Bank explained that, with securities settlement arrangements experiencing a ‘period of rationalisation’, the proposed changes under the Bill complement other market developments. The Reserve Bank is in the process of transferring its role in the settlement of CGS to another entity, Austraclear. This shift will come into effect in the March quarter of 2002. Although the changeover is independent of the Bill, it is consistent with the Bill's aims.⁴

1.11 The Reserve Bank stated that the transfer to Austraclear has ‘the strong support of market participants, as it will allow them to lower their costs; in future they will need to maintain access to only one system to settle trades on all their debt securities.’⁵ The Reserve Bank notes that at present there are three separate settlement systems for securities in Australia:

- Reserve Bank Information and Transfer System (RITS) for CGS;
- Austraclear for private sector and State government debt securities; and
- CHES for equities.

² Submission No. 1, p.2.

³ Ibid.

⁴ Submission No. 2, pp.2-4.

⁵ Ibid, p.2

1.12 The Reserve Bank explained that in agreeing to the transfer to Austraclear it has assured itself that Austraclear will offer a level of service and security that is comparable to that offered by RITS.⁶

1.13 As stipulated in the Financial Services Reform Act, the Reserve Bank will remain responsible for the regulation and compliance standards of securities clearing and settlement activities.

1.14 The Reserve Bank also pointed to the implications of the amendments carried in the Bill, particularly greater market competition in registry and settlement services.⁷

1.15 As stated above, the Bill also deals with the appointment of Registrars under the CIS Act instead of, or in addition to, the Reserve Bank of Australia.

1.16 The Reserve Bank explained that it is willing to provide registry services to the Commonwealth while ever the Commonwealth wishes it to do so. The Reserve Bank also provided data indicating that the cost to the Commonwealth of the Reserve Bank providing those services has fallen significantly in recent years.⁸

1.17 The Reserve Bank stated that:

Given the importance of CGS to the financial system, it would be essential that any other provider of registry services for these securities meets the very highest standards of integrity and efficiency. As well as ensuring very high standards of service, any such registry would need to be able to offer an efficient interface to potential suppliers of settlement systems.⁹

1.18 In its submission, the Australian Office of Financial Management (AOFM) addressed a number of concerns that were raised in the House of Representatives at the time of the Bill's introduction. Its answers to those concerns are at Appendix 1.

1.19 In particular, the AOFM noted that it plans to seek the application of competitive tendering principles to the registry function. The AOFM stated that:

An external Registrar would be recommended only if it was demonstrated that the registry function could be undertaken more efficiently (i.e. at a lower overall cost, without sacrifice of quality of service) and that no additional risks impacted in relation to the payments of interest/redemption, or that no other systemic risks arose with regard to CGS payments.¹⁰

1.20 The AOFM explained that it has not actively canvassed alternate registry providers.

⁶ Ibid. p.3

⁷ Ibid, p.4.

⁸ Ibid, pp.2-3

⁹ Ibid. p.3

¹⁰ Submission No. 3, p.2

Recommendation

1.21 The Committee recommends that the Bill be passed.

Senator the Hon. Brian Gibson
Chairman



Mr Peter Hallahan
Committee Secretary
Economics Legislation Committee
Parliament House
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Dear Mr Hallahan

COMMONWEALTH INSCRIBED STOCK (CIS) AMENDEMENT BILL 2001

Thank you for your letter of 15 October 2001 inviting the Australian Office of Financial Management (AOFM) to make a submission on the Commonwealth Inscribed Stock Amendment Bill 2001.

While we acknowledge that this Bill has now lapsed and will need to be reintroduced by the incoming Government, in order to facilitate any future debate and clarify a number of matters, particularly the questions raised by the Opposition during consideration of the Bill, we welcome the opportunity to make a number of comments.

Background

Under the provisions of the *Commonwealth Inscribed Stock (CIS) Act 1911*, the Reserve Bank of Australia (RBA), as Registrar to the Commonwealth in which it manages interest and redemption payments to bondholders, currently records transfers of title to paper-based Commonwealth Government securities (CGS). However, to capitalise on current market practices and electronic facilities, the Bank also provides under its RITS system (albeit in a less than ideal fashion) a contractually based mechanism for the electronic transfer of CGS between participants in the wholesale market that are registered with it.

Consequently, the proposed amendments to the CIS Act are intended:

- primarily to facilitate, without the need to establish a complicated structure such as the present 'chase in action' system, electronic transfer of title to CGS by both the Reserve Bank or any other body that may be appointed, either as a main Registrar or as a sub-Registrar; and
- move the Commonwealth's registry system towards market best practice.

Moreover, the proposed amendments strengthen the regulatory regime by providing that only clearance and settlement entities licensed and regulated under the *Corporations Act* may be appointed Registrars. By strengthening the regulatory regime, the proposed amendments will, in fact, reduce risks associated with the issuance of CGS under a non-Government registry provider.

- It should be noted that the existing legislation already provides, at section 14, for the Treasurer to appoint non-government Registrars of Stock.

Questions Raised

There were 8 questions raised in the House with regard to the proposed legislation. The AOFM provides the following comments on these:

- (1) The cost of the registry function performed by the RBA in 2001-02 is expected to be about \$616,000 (which includes \$55,600 GST).
- (2) Currently, registry services are provided by the RBA. Going forward, and consistent with Government procurement guidelines, the AOFM plans to seek the application of competitive tendering principles to the registry function.

An external Registrar would be recommended only if it was demonstrated that the registry function could be undertaken more efficiently (i.e. at a lower overall cost, without sacrifice of quality of service) and that no additional risks impacted in relation to the payments of interest/redemption, or that no other systemic risks arose with regard to CGS payments.

- (3) The AOFM has not actively canvassed alternate registry providers.
- (4) Issues relating to the electronic trading and transfer of the direct beneficial and legal interests in CGS were canvassed in the CLERP discussion papers.
- (5) Historically, the Registry was the main vehicle for recording ownership of CGS. But the requirement in the CIS Act that changes in ownership of CGS be effected through paper-based systems made it impractical for the Registry to handle the sharp increase in the volume of market transactions that followed financial deregulation in the 1980s.

The RBA therefore set up a separate electronic settlement system for CGS, known as RITS, which is separate from the registry function. Under RITS, market participants wishing to settle their CGS transactions electronically transfer their securities into a pooled account in the Registry. This account is held in the name of the RBA. The RBA then issues claims on those securities, which dealers can transfer electronically in RITS.

- (6) In order to help rationalise the settlement systems for debt securities in Australia, the RBA and Austraclear, with the strong support of market participants, have agreed to bring the settlement of all debt securities in Australia into one system. Accordingly, the RBA has advised that from the March quarter 2002, the settlement of CGS will be shifted to Austraclear, which currently settles transactions in debt securities other than CGS.

We understand that the RBA will be elaborating on these issues in a separate submission to the Committee.

- (7) The AOFM is satisfied as to the ability of the RBA to provide a certain and secure framework for the electronic transactions of CGS.

- (8) The AOFM is of the firm view that no additional risks impact on CGS/yields from the changes proposed in this Bill.
- Firstly, the existing legislation already provides for the Government to appoint a Registrar other than the RBA.
 - Secondly, the Government would appoint a new registry provider only if it was completely satisfied that no additional risks impacted on the integrity of the clearance and settlement system, the payments system more generally, or the CGS market in particular.

Yours sincerely

Michael Allen
Chief Executive Officer