



ASIC

Australian Securities & Investments Commission

CONSULTATION PAPER 181

Retail trading in Commonwealth Government Securities

July 2012

About this paper

This consultation paper is for market operators and market participants that may trade in depository interests in Commonwealth Government Securities (CGS) (CGS depository interests) on Australian financial markets that are accessible to retail investors (i.e. public exchanges).

It proposes amendments to the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 that we consider are necessary to facilitate the Australian Government's decision to allow retail trading of CGS depository interests on public exchanges.

It also seeks feedback on the extent to which our proposals should apply to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges.

About ASIC regulatory documents

In administering legislation ASIC issues the following types of regulatory documents.

Consultation papers: seek feedback from stakeholders on matters ASIC is considering, such as proposed relief or proposed regulatory guidance.

Regulatory guides: give guidance to regulated entities by:

- explaining when and how ASIC will exercise specific powers under legislation (primarily the Corporations Act)
- explaining how ASIC interprets the law
- describing the principles underlying ASIC's approach
- giving practical guidance (e.g. describing the steps of a process such as applying for a licence or giving practical examples of how regulated entities may decide to meet their obligations).

Information sheets: provide concise guidance on a specific process or compliance issue or an overview of detailed guidance.

Reports: describe ASIC compliance or relief activity or the results of a research project.

Document history

This paper was issued on 20 July 2012 and is based on the Corporations Act as at the date of issue.

Disclaimer

The proposals, explanations and examples in this paper do not constitute legal advice. They are also at a preliminary stage only. Our conclusions and views may change as a result of the comments we receive or as other circumstances change.

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The consultation process

You are invited to comment on the proposals in this paper, which are only an indication of the approach we may take and are not our final policy.

As well as responding to the specific proposals and questions, we also ask you to describe any alternative approaches you think would achieve our objectives.

We are keen to fully understand and assess the financial and other impacts of our proposals and any alternative approaches. Therefore, we ask you to comment on:

- the likely compliance costs;
- the likely effect on competition; and
- other impacts, costs and benefits.

Where possible, we are seeking both quantitative and qualitative information. We are also seek your feedback on any other issues you consider important.

Making a submission

We will not treat your submission as confidential unless you specifically request that we treat the whole or part of it (such as any financial information) as confidential.

Comments should be sent by 31 August 2012 to:

Anastasia Zafeirakopoulos
 Financial Market Infrastructure
 Australian Securities and Investments Commission
 Level 5, 100 Market Street
 Sydney NSW 2000
 facsimile: (02) 9911 2414
 email: marketstructure@asic.gov.au

For any inquiries, please contact Anastasia Zafeirakopoulos, on (02) 9911 2595 or Linda Cook, on (02) 9911 2653.

What will happen next?

Stage 1	20 July 2012	ASIC consultation paper released
Stage 2	31 August 2012	Comments due on the consultation paper
Stage 3	October–December 2012	ASIC market integrity rules are made

A About this consultation paper

Key points

This consultation paper outlines our proposals to extend the scope of and adapt rules from the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011 (competition market integrity rules) for trading in CGS depository interests on public exchanges. The proposals are part of the framework required to help implement the Australian Government's initiative to facilitate retail trading of CGS depository interests on public exchanges on a non-exclusive basis.

The proposals do not apply to CGS that are traded over-the-counter (OTC) or on professional financial markets.

This consultation paper also seeks feedback on the extent to which our proposals should apply to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges, as part of the Government's broad agenda to develop a deep and liquid corporate bond market.

Purpose of this consultation paper

Government plans to introduce trading in CGS depository interests on public exchanges

- 1 On 12 December 2010, the Australian Government (Government) announced that it would facilitate the trading of Commonwealth Government Securities (CGS) on Australian financial markets that are accessible to retail investors.¹
- 2 CGS are mainly traded over-the-counter (OTC) and through trading platforms available to professional investors only (professional financial markets). Allowing CGS to trade on financial markets that are accessible to retail investors is expected to give retail investors a more visible pricing benchmark for investments they may wish to make in corporate bonds. In addition, it could further encourage retail investors to consider diversifying their savings through investments in fixed-income products like government and corporate bonds. This, in turn, is expected to facilitate the Government's broad agenda of fostering a deep and liquid corporate bond market.²

¹ The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Media Release No. 91, *A competitive and sustainable banking system*, 12 December 2010, <http://ministers.treasury.gov.au/wmsDisplayDocs.aspx?doc=pressreleases/2010/091.htm&pageID=003&min=wms&Year=2010&DocType=0>.

² The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Media Release No. 155, *Developing the retail corporate bond market*, 13 December 2011, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/155.htm&pageID=003&min=wms&Year=&DocType>.

- 3 On 1 November 2011, the Australian Office of Financial Management (AOFM), acting on behalf of the Government, released the open-ended ‘Request for Proposals: Trading of Commonwealth Government Securities on financial markets in Australia’ (Request for Proposals). The Request for Proposals seeks proposals for the trading of CGS from market operators licensed to operate a financial market in Australia under s795B(1) of the *Corporations Act 2001* (Corporations Act) and authorised to trade in CGS with participants transacting on the market on behalf of retail investors.³ These markets are referred to in this paper as ‘public exchanges’ or ‘CGS markets’.
- 4 AOFM’s Request for Proposals notes that the Government issues CGS in the form of Treasury Bonds,⁴ Treasury Indexed Bonds⁵ and Treasury Notes,⁶ but the proposals need not consider trading of Treasury Notes. It also states that, consistent with the aim of promoting competition in the provision of financial services, more than one proposal may be accepted—that is, CGS could be traded on more than one public exchange.
- 5 On 13 December 2011, the Government made a further announcement, reiterating its commitment to allowing retail investors to buy and trade CGS on a retail platform, as for trading in equities.⁷ The Government stated that its discussions with potential market operators indicated that an ‘indirect’ or ‘beneficial ownership’ type of trading model would be the most efficient, cost-effective and timely method for facilitating retail trading in CGS, and that the Government would consider proposals from market operators based on such a model. Beneficial ownership models typically involve depository interests. Treasury Bonds, Treasury Indexed Bonds and depository interests issued in these products are referred to in this paper as ‘CGS products’.
- 6 On 27 June 2012, the Government introduced the Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012, proposing amendments to:
- (a) the *Commonwealth Inscribed Stock Act 1911* (which provides an overall framework for the activities of the AOFM in issuing, selling and managing CGS) to facilitate trading of beneficial interests in CGS on public exchanges; and

³ AOFM, ‘Request for proposals: Trading of Commonwealth Government Securities on financial markets in Australia’ (AOFM01112011), request for tender, 1 November 2011.

⁴ Treasury Bonds are medium- to long-term debt securities that carry an annual rate of interest fixed over the life of the security, payable every six months in arrears. Treasury Bonds are redeemable at face value on maturity.

⁵ Treasury Indexed Bonds are medium- to long-term securities for which the capital value of the security is adjusted for movements in the consumer price index (CPI). Interest is paid quarterly, at a fixed rate, on the adjusted capital value. At maturity, investors receive the adjusted capital value of the security—the value adjusted for movement in the CPI over the life of the bond.

⁶ Treasury Notes are short-term securities issued to assist with the Australian Government’s within-year financing task.

⁷ The Hon Wayne Swan MP, Deputy Prime Minister and Treasurer, Media Release No. 155, *Developing the retail corporate bond market*, 13 December 2011, <http://ministers.treasury.gov.au/DisplayDocs.aspx?doc=pressreleases/2011/155.htm&pageID=003&min=wms&Year=&DocType>.

- (b) the Corporations Act to require financial advisers to provide a prescribed information statement to retail clients when they give them personal advice about investing in CGS.⁸

7 We understand that AOFM plans to implement trading of CGS depository interests, as foreshadowed in these announcements, on one or more public exchanges in the near future. As yet, AOFM has made no announcement about the identity of such public exchanges. Our proposals therefore accommodate a range of market operators, as well as the case where only one market operator enters into arrangements with AOFM.

Regulatory framework for CGS depository interests

8 This consultation paper outlines the regulatory proposals that we consider are necessary, and form one aspect of the overall process required, to implement the Government's initiative to facilitate trading by retail investors in CGS depository interests.

9 Our proposed approach in general is to extend the scope of and adapt selected provisions of the competition market integrity rules to apply to CGS depository interests in a tailored way. It is intended that these extended and adapted rules will include relevant market integrity rules based on our planned market structure reforms described in Consultation Paper 179 *Australian market structure: Draft rules and guidance* (CP 179). This is in addition to any market integrity rules that will apply to the specific markets on which CGS depository interests are traded.

Note: In this paper 'competition market integrity rules' refers to the ASIC Market Integrity Rules (Competition in Exchange Markets) 2011, as amended.

10 Table 1 provides an overview of our proposals in terms of key changes to the competition market integrity rules.

Note: For a draft version of the competition market integrity rules, as proposed to be amended in CP 179, marked up with our further proposed amendments, see the attachment to this consultation paper. At this stage, we expect to make the revised rules in the fourth quarter of 2012, subject to Ministerial consent under s798G of the Corporations Act.

11 We are conscious that, at this time, AOFM has not entered into arrangements with any market operator under its Request for Proposals, and that market participants, in particular, may not know with certainty the extent to which the proposals in this paper will apply to them. However, we are also aware of the Government's timetable for implementing retail trading in CGS depository interests in the near future.

⁸ The Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012 was introduced in the House of Representatives on 27 June 2012: see: http://parlinfo.aph.gov.au/parlInfo/download/legislation/bills/r4857_first-reps/toc_pdf/12129b01.pdf;fileType=application%2Fpdf.

- 12 In light of these issues, we are consulting on our proposed changes to the competition market integrity rules now. This is because:
- (a) market operators of public exchanges may wish to take our proposals into account when considering whether to make submissions in response to AOFM's Request for Proposals; and
 - (b) market operators and market participants of public exchanges that enter into arrangements with AOFM will require certainty about the regulatory framework that will apply before they can commence implementing compliance arrangements, and will need time to implement those arrangements before retail trading in CGS depository interests commences on their market.
- 13 Further, given the Government's broad agenda to foster a deep and liquid corporate bond market, the market integrity rules for retail trading in CGS depository interests may ultimately become the model for an enhanced regulatory framework for trading in a range of retail debt market products. For that reason, various questions in this paper also ask respondents to consider the application of the proposed framework to retail debt market products, including corporate debt, that are or may be traded on public exchanges.⁹

Trading in CGS on wholesale market

- 14 The proposed market integrity rules will only apply to CGS depository interests traded on public exchanges, and not to the underlying CGS. Accordingly, the proposals in this consultation paper will not affect trading in CGS on the wholesale market (i.e. OTC and professional financial markets). As noted in paragraph 2 of this consultation paper, CGS in the form of Treasury Bonds, Treasury Indexed Bonds and Treasury Notes are currently traded on the wholesale market. Relevant professional financial markets are either exempt from the requirement to hold an Australian market licence,¹⁰ or exempt from the operation of Pt 7.2A of the Corporations Act.¹¹
- 15 Where the operator of a financial market that is currently exempt from the operation of Pt 7.2A of the Corporations Act wishes to enter into an arrangement with AOFM to offer trading services in CGS depository interests, we consider the exemption from Pt 7.2A of the Corporations Act

⁹ See paragraphs 100–101 for a description of the products that are traded on public exchanges that we refer to as 'debt market products' in this paper.

¹⁰ Creditex Brokerage LLP, TradeWeb Europe Ltd, Tullett Prebon (Australia) Pty Ltd, ICAP Brokers Pty Ltd and GFI Brokers Ltd are relevant financial markets currently exempt from the requirement to hold a market licence: see Consultation Paper 116 *Exempt professional financial markets* (CP 116).

¹¹ BGC Partners (Australia) Pty Limited, Bloomberg Tradebook Australia Pty Ltd and Yieldbroker Pty Limited are relevant financial markets currently exempt from the operation of Pt 7.2A of the Corporations Act: see reg 10.15.02 of the Corporations Regulations 2001.

should not apply to these trading services, and we are minded to advise the Government accordingly.

- 16 Under the AOFM's Request for Proposals, CGS may eventually be traded on a public exchange in the form of Treasury Bonds and Treasury Indexed Bonds (rather than the depository interests for those products). In that event, we would consider further, and consult on, the need for regulatory changes, including possible changes to the competition market integrity rules or exchange-specific market integrity rules.

Who should read this consultation paper

- 17 The proposals in this consultation paper may affect market operators that wish to enter into arrangements with AOFM to provide trading services in CGS depository interests, and their market participants.
- 18 This paper also seeks feedback on the extent to which our proposals should apply to other retail debt market products that are or may be traded on public exchanges. Market operators of public exchanges that do or may offer trading in these products, and their market participants, may therefore also be affected.
- 19 This consultation paper should be read in conjunction with:
- (a) CP 179;
 - (b) the proposed amended competition market integrity rules (see the attachment to this paper, which shows our additional proposed changes beyond those proposed in CP 179); and
 - (c) the draft amended Regulatory Guide 223 *Guidance on ASIC market integrity rules for competition in exchange markets* (RG 223), at Attachment 2 to CP 179.¹²

Your feedback

- 20 We seek your feedback on:
- (a) our specific proposals for amending the competition market integrity rules to apply to CGS depository interests;
 - (b) the draft amendments to the competition market integrity rules that reflect the proposals (see the attachment to this paper); and
 - (c) the extent to which our proposals should apply to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges.

¹² We intend to issue an amended RG 223: see Attachment 2 to CP 179.

- 21 In developing our proposals, we have considered feedback in response to Consultation Paper 168 *Australian equity market structure: Further proposals* (CP 168). We have also considered our proposed approach in CP 179, and will take into account the feedback we receive on CP 179 in finalising our proposals.

B Background and summary of proposals

Key points

In Australia, CGS have historically been traded on OTC markets or professional financial markets, with limited retail trading, either through a Reserve Bank of Australia (RBA) facility or intermediaries.

The Government intends to introduce retail trading of CGS on public exchanges in the form of CGS depository interests.

We propose to extend and adapt the competition market integrity rules to apply to market operators and market participants in relation to CGS depository interests traded on public exchanges.

We are also seeking feedback on how these proposals might apply to other retail debt market products (including corporate bonds and depository interests in corporate bonds) that are or may be traded on public exchanges.

Trading in CGS and debt on Australian markets

- 22 Trading in CGS in Australia predominantly takes place on the wholesale market—that is, on OTC or professional financial markets. Retail investors can trade in CGS either through a facility provided by the RBA or through intermediaries. However, direct retail participation in trading CGS on Australian markets has been limited. The appendix to this consultation paper provides more background on trading in CGS, and in retail debt more broadly, in the Australian market.
- 23 CGS traded on the wholesale market are currently registered and settled through the Austraclear System, which is ASX Limited’s (ASX’s) settlement facility for debt securities traded OTC and on professional financial markets.
- 24 As noted in paragraph 5, the Government has decided to consider proposals for retail trading of CGS based on an ‘indirect’ or ‘beneficial ownership’ type of trading model. Beneficial ownership models are already used on public exchanges for financial products that, for some reason, cannot be directly traded on a financial market.¹³

¹³ Examples are bearer securities, securities held in another settlement and depository system or foreign-listed shares.

Regulatory framework

Regulatory framework for public exchanges

- 25 Market operators of public exchanges are licensed by ASIC under s795B(1) of the Corporations Act and are subject to obligations under Pt 7.2 of that Act, including the obligation to maintain a fair, orderly and transparent market: s792A(a). Participants in public exchanges are generally required to be licensed under s911A of the Corporations Act and are subject to a range of obligations under the market's operating rules and Ch 7 of that Act, including the obligation to provide financial services efficiently, honestly and fairly: s912A(1)(a).
- 26 Under Pt 7.2A of the Corporations Act, ASIC has the function of supervising public exchanges, and may make market integrity rules dealing with the activities and conduct of public exchanges, and of persons in relation to public exchanges, and financial products traded on public exchanges. Market operators and participants must comply with the market integrity rules that apply to them. The making of market integrity rules, including those proposed in this consultation paper, is subject to Ministerial consent under s798G of the Corporations Act and Parliamentary disallowance.
- 27 In August 2010, ASIC made market-specific market integrity rules dealing with the activities and conduct of the markets operated by ASX, Australian Securities Exchange Limited, Asia Pacific Exchange Limited, IMB Ltd, National Stock Exchange of Australia Limited (NSXA) and SIM Venture Securities Exchange Ltd.
- 28 In April 2011, we made the competition market integrity rules, providing a robust, minimum regulatory framework for competition between public exchanges in trading services in 'equity market products'.¹⁴ At that time, we also made market integrity rules dealing with the activities and conduct of the public exchange operated by Chi-X Australia Pty Limited (Chi-X).
- 29 In October 2011, we released CP 168, proposing enhancements to the ASIC market integrity rules for the ASX and Chi-X markets and the competition market integrity rules that we considered necessary to keep pace with technological developments and global financial market trends in equity market products. On 28 June 2012, following on from CP 168, we released CP 179 and draft market integrity rules and guidance on market structure reforms.
- 30 We propose to build on these proposals by extending the scope of and adapting the competition market integrity rules (as proposed to be amended

¹⁴ 'Equity market products' are shares, interests in managed investment schemes (including exchange-traded funds), rights to acquire shares or interests in managed investment schemes under a rights issue, and CDIs admitted to quotation on ASX. They do not include a range of products, including (for the purposes of this consultation paper) CGS.

in CP 179) to apply to CGS depository interests traded on public exchanges, with suitable amendments.

Proposed regulatory framework for CGS

Market-specific market integrity rules for trading in CGS depository interests on public exchanges

- 31 We consider that, consistent with our approach to supervision, each public exchange on which CGS depository interests are traded should be subject to market integrity rules specifically dealing with the activities or conduct of the market operator and market participants in relation to those products.
- 32 This means that, where a public exchange enters into an arrangement with AOFM to provide trading services in CGS depository interests, we will consider whether the existing operating rules and market integrity rules for that exchange apply or could be applied to CGS depository interests, and if so, whether those operating rules and market integrity rules are together adequate to enable us to supervise trading in CGS depository interests on that market.
- 33 The ASIC market integrity rules for the ASX, Chi-X and NSXA markets, for example, provide a regulatory framework for the operator and participants of these markets, including obligations for participants in relation to:
- (a) adequate management structures, supervisory procedures and insurance arrangements;
 - (b) the appointment of responsible executives/officers and designated trading representatives;
 - (c) dealings with clients including disclosure, reporting, record-keeping, client money handling and client order priority requirements; and
 - (d) conduct that may interfere with the efficiency, integrity or orderly conduct of the market.
- 34 We would anticipate that a public exchange offering trading in CGS depository interests would require market integrity rules dealing with some or all of these requirements. However, we will consider each public exchange on an individual basis.
- 35 Where appropriate, we may propose new or amended market integrity rules specific to the relevant public exchange and would undertake a separate consultation in relation to any such proposals.

Applying the competition market integrity rules to trading in CGS depository interests on public exchanges

- 36 In addition to market-specific market integrity rules, all public exchanges on which CGS depository interests are traded should be subject to the enhanced market integrity rule framework that currently applies to public exchanges that offer trading services in equity market products.
- 37 In Sections C–I of this consultation paper, we propose to extend the competition market integrity rules to cover trading in CGS depository interests. In proposing these amendments, we have built on our proposals in CP 179.
- 38 The rationale for this approach is that the existing regulatory framework for equity market products achieves the regulatory objectives of market integrity, investor protection and fairness that can be applied appropriately to CGS depository interests in both a single market and multimarket environment. The implementation of the proposals set out in CP 179 will further enhance that framework.
- 39 In applying this regulatory framework, we have considered:
- (a) the differences between CGS depository interests and equity market products and the manner in which these products trade; and
 - (b) the desirability of encouraging retail investors to trade in CGS depository interests and providing a visible pricing benchmark for investments retail investors may wish to make in corporate bonds.

Penalties

- 40 This consultation paper does not propose specific penalties for contravention of the proposed competition market integrity rules that will apply to trading in CGS depository interests. Where a proposal involves amending an existing market integrity rule, consistent penalties will apply.

Timing

- 41 As noted earlier, AOFM seeks to implement trading in CGS depository interests on one or more public exchanges in the near future.
- 42 We are working towards finalising the regulatory framework for CGS depository interests in the last quarter of 2012.

Table 1: Our regulatory approach

Issue	Key changes to competition market integrity rules relative to CP 179 proposals
Scope of products and persons (Section C)	<p>We propose to extend the scope of the competition market integrity rules from equity market products to include CGS depository interests.</p> <p>We also propose to extend the application of the competition market integrity rules from equity market operators and participants to market operators offering retail trading in CGS depository interests and their participants.</p>
Extreme price movements (Section D)	<p>We propose to extend the extreme price movement regime in Chapter 2 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests.</p> <p>For CGS depository interests, we propose to apply a single extreme trade range band of 20% or more away from the reference price, and allow ASIC to determine who is the responsible market operator for CGS when there is more than one CGS market.</p>
Best execution (Section E)	<p>We propose to extend the best execution obligations in Chapter 3 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests.</p>
Pre-trade transparency (Section F)	<p>We propose to extend the pre-trade transparency requirements in Chapter 4 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests. The required pre-trade information has been made specific to CGS depository interests.</p> <p>We propose that transactions in CGS depository interests be entitled to the block trade exception where the consideration for the transaction is \$200,000 or more (consistent with the proposed exception in CP 179 for Tier 3 equity market products).</p>
Post-trade transparency (Section F)	<p>We propose to extend the scope of the post-trade transparency regime in Chapter 5 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests. The required post-trade information has been made specific to CGS depository interests.</p> <p>We propose that transactions in CGS depository interests be entitled to delayed post-trade reporting where the consideration for the transaction is \$2,000,000 or more (consistent with delayed reporting for Category D equity market products).</p>
Regulatory data for market surveillance (Section G)	<p>We propose to extend the scope of the proposed regulatory data regime in Chapter 5A of the competition market integrity rules (as proposed to be inserted in CP 179) to CGS depository interests.</p>
Market operators: Other obligations (Section H)	<p>We propose to extend the scope of the other market operator obligations in Chapter 6 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests.</p> <p>We propose a single tick size of \$0.001 for CGS depository interests.</p>
Market participants: Other obligations (Section I)	<p>We propose to extend the scope of the other market participant obligations in Chapter 7 of the competition market integrity rules to CGS depository interests.</p>

C Scope of the proposals

Key points

Our proposals extend the scope of the competition market integrity rules to include CGS depository interests.

We also propose to extend the scope of the competition market integrity rules to include market operators offering retail trading in CGS depository interests under arrangement with the AOFM, and their participants.

Products to which our proposals apply

Proposal

- c1** We propose to extend the product scope of the competition market integrity rules to apply to all CGS depository interests that are traded on public exchanges.

Your feedback

- c1Q1** Do you agree that the proposals in this paper should apply to CGS depository interests traded on public exchanges?
- c1Q2** To what extent should our proposals apply to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

Rationale

CGS depository interests

- 43 The product scope of the proposals in this consultation paper reflects AOFM's Request for Proposals, the Government announcements of 12 December 2010 and 13 December 2011, and the Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012: see Section A. Because there are existing OTC and professional financial markets in Treasury Bonds and Treasury Indexed Bonds, the proposals only apply to trading in depository interests over these products, when that trading takes place on public exchanges.
- 44 The measure to facilitate the trading of CGS in Australia on financial markets accessible to retail investors forms part of a collection of Government measures to promote a competitive and sustainable banking system. The overall objectives of the measures are to improve consumer protection in banking services, support smaller lenders in increasing competitive pressure on the big banks, and secure the long-term safety and

sustainability of the Australian financial system by reducing reliance on offshore wholesale funding markets.¹⁵

- 45 As part of these objectives, the Government has committed to fostering a deep and liquid corporate bond market. Trading of CGS on financial markets accessible to retail investors is a crucial element of this proposal because it provides retail investors with a visible pricing benchmark for investments they may wish to make in corporate bonds. Establishing a strong and liquid retail market in the premium debt security—that is, CGS—is considered a critical step in the formation of a wider retail debt market, including corporate debt.¹⁶

Other debt market products

- 46 We are seeking feedback on applying the proposals in this paper to other retail debt market products that are or may be traded on public exchanges because of the increasing Government and market focus on the desirability of fostering such a market, reflecting the Government objectives mentioned.
- 47 Products to which the proposals in this paper could apply include depository interests in corporate bonds, corporate bonds themselves, and a range of other products such as hybrid securities that are already traded to some extent. We would not apply the proposals in this paper to such securities without a further policy development process, including public consultation. However, we invite early views on these questions to better inform our thinking.

Persons to whom the proposals apply

Proposal

- c2 We propose to extend the application of the competition market integrity rules to:
- (a) an Australian market licence holder that has entered into arrangements with AOFM to operate a market in CGS depository interests (CGS market operator); and
 - (b) a market participant in such a market (CGS market participant).

Your feedback

C2Q1 Do you agree with the proposed application of our proposals?

C2Q2 Are there other persons to whom the proposals in this paper should apply? If so, who and why?

¹⁵ See paragraph 1.2 of the Explanatory Memorandum to the Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012

¹⁶ See paragraph 1.3 of the Explanatory Memorandum to the Commonwealth Government Securities Legislation Amendment (Retail Trading) Bill 2012

Rationale

- 48 The scope of persons to whom the proposals in this paper apply reflects AOFM's Request for Proposals, and the Government announcements of 12 December 2010 and 13 December 2011: see Section A.
- 49 As stated in Section A, trading in CGS on existing OTC and professional financial markets is not affected by these proposals.

D Extreme price movements

Key points

Our proposals extend the extreme price movement regime in Chapter 2 of the competition market integrity rules (as proposed to be amended by CP 179) to CGS depository interests.

For CGS depository interests, we propose to apply a single extreme cancellation range (ECR) band of 20% or more away from the reference price.

Chapter 2 of the competition market integrity rules

Proposal

- D1 We propose to extend the application of Chapter 2 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS market operators offering retail trading in CGS depository interests, except that:
- (a) we propose a single extreme trade range band of more than 20% from the reference price for CGS depository interests; and
 - (b) we propose that, where there is more than one CGS market operator, ASIC will determine who is the responsible CGS market operator (and therefore responsible for determining the extreme trade range reference prices and initiating the imposition and lifting of trading pauses when there is an extreme trade range event).

We will also take into account any amendments to Chapter 2 following on from CP 179.

See draft amended Chapter 2 of the competition market integrity rules.

Your feedback

- D1Q1 Do you agree that applying some controls around extreme price movements for CGS depository interests would be desirable?
- D1Q2 If so, do you agree with our proposals?
- D1Q3 In particular, do you agree with our proposed extreme cancellation range of more than 20% away from the reference price?
- D1Q4 If not, do you have any alternative proposal to deal with the threat posed by extreme price movements to market integrity or investor confidence in relation to CGS depository interests?

D1Q5 What is the likely impact of our proposals? (For all your responses to questions on impact, please identify the nature of likely costs, quantify the estimated costs and indicate whether such costs will be one-off or ongoing.) What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?

Rationale

- 50 Chapter 2 of the competition market integrity rules requires equity market operators to have in place anomalous order entry controls and to cancel transactions in equity market products that may occur in the extreme cancellation range. In CP 179, we have proposed amending Chapter 2 of the competition market integrity rules to require equity market operators to prevent transactions in the extreme trade range.
- 51 The rationale for, and operation of, the existing and proposed controls around extreme price movements are set out more fully in Section B of draft amended RG 223 at Attachment 2 to CP 179.
- 52 We think controls around extreme price movements will be important to maintain market integrity and investor confidence in the market for CGS depository interests.
- 53 The main difference between our proposals and the position in CP 179 is that we are proposing a single extreme trade range band for CGS depository interests of 20% or more away from the reference price. We are proposing this because the nominal value of CGS depository interests will be \$100 and this aligns with the proposed extreme trade range for equity market products in that price range.

E Best execution

Key points

Our proposals extend the best execution obligations in Chapter 3 of the competition market integrity rules to CGS depository interests.

Chapter 3 of the competition market integrity rules

Proposal

E1 We propose to extend Chapter 3 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS market participants trading in CGS depository interests on behalf of clients.

See draft amended Chapter 3 of the competition market integrity rules.

Your feedback

- E1Q1 Do you agree with our proposal to apply the best execution regime in Chapter 3 of the competition market integrity rules to CGS depository interests?
- E1Q2 What is the likely impact of our proposals? What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?
- E1Q3 To what extent should the best execution regime be applied to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

Rationale

- 54 Chapter 3 of the competition market integrity rules requires equity market participants to take reasonable steps to obtain the best outcome for their clients in handling and executing orders, and to have in place a range of policies and procedures for complying with their best execution obligation.
- 55 The rationale for, and operation of, existing best execution obligations is set out more fully in Section C of draft amended RG 223 at Attachment 2 to CP 179.
- 56 A best execution obligation will help to ensure retail investors are confident that they are receiving quality of execution when they trade in CGS depository interests.
- 57 We consider that this rationale applies to CGS depository interests, both when participants have a choice of venues on which to trade and when only

a single market offers trading in CGS depository interests. In the latter case, the best execution obligation will oblige brokers to obtain the best outcome, taking into consideration factors such as timing of execution. It will also oblige brokers to provide evidence of best execution performance on request by a client.

F Pre-trade and post-trade transparency

Key points

Our proposals extend the pre-trade transparency requirement in Chapter 4 of the competition market integrity rules (as proposed to be amended by CP 179) to CGS depository interests.

We propose to extend the block trade exception to CGS depository interests where the consideration for the transaction is \$200,000 or more (consistent with the proposed exception in CP 179 for Tier 3 equity market products).

We also propose apply the post-trade transparency regime in Chapter 5 of the competition market integrity rules (as proposed to be amended by CP 179), currently applicable to equity market products, to CGS depository interests.

The required post-trade information has been made specific to CGS depository interests. We propose that transactions in CGS depository interests be entitled to delayed post-trade reporting where the consideration for the transaction is \$2,000,000 or more (consistent with delayed reporting for Category D equity market products).

Chapters 4 and 5 of the competition market integrity rules

Proposal

- F1 We propose to extend Chapter 4 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS market operators offering trading services in CGS depository interests, and CGS market participants dealing in CGS depository interests, except that:
- (a) a CGS market operator will be required to make available different pre-trade information for CGS depository interests, as set out in draft new Rule 4.1.4A;
 - (b) we will extend the block trade exception to CGS depository interests where the consideration for the transaction is \$200,000 or more (consistent with the proposed exception in CP 179 for Tier 3 equity market products).

We will also take into account any amendments to Chapter 4 following on from CP 179.

See draft amended Chapter 4 of the competition market integrity rules.

Your feedback

- F1Q1 Do you agree with our proposal to apply the pre-trade transparency regime in Chapter 4 of the competition market integrity rules to CGS depository interests?

F1Q2 Do you agree that we should provide parallel exceptions from the pre-trade transparency regime? Do you agree that this could encourage wholesale interest in CGS depository interests?

F1Q3 Do you consider that the crossing system reporting information set out in Rule 4.3.3 should be amended for crossing systems that execute orders for CGS depository interests? If so, how?

F1Q4 What is the likely impact of our proposals? What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?

F1Q5 To what extent should the pre-trade transparency proposals be applied to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

F2 We propose to extend Chapter 5 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS market operators and their market participants, except that:

- (a) the market operator will be required to make available different post-trade information, as set out in draft new Rule 5.1.7A;
- (b) the market operator will be required to make available different trading information within 20 minutes on its website, as set out in draft new Rule 5.1.6(3); and
- (c) we will extend the delayed post-trade reporting regime (under Part 5.2 of the competition market integrity rules) to CGS depository interests where the consideration for the transaction is \$2,000,000 or more (consistent with delayed reporting for Category D equity market products).

We will also take into account any amendments to Chapter 5 following on from CP 179.

See draft amended Chapter 5 of the competition market integrity rules.

Your feedback

F2Q1 Do you agree with our proposal to apply the post-trade transparency regime in Chapter 5 of the competition market integrity rules to CGS depository interests?

F2Q2 Do you agree with our proposals for the data items for the purposes of Rules 5.1.6(3) and 5.1.7A?

F2Q3 Do you agree with our proposals for the threshold for the delayed reporting regime in Part 5.2 of the competition market integrity rules?

F2Q4 What is the likely impact of our proposals? What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?

F2Q5 To what extent should proposal F2 be applied to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

Rationale

- 58 Chapters 4 and 5 of the competition market integrity rules require:
- (a) transactions in equity market products to be executed on the order book of a public exchange, and on a pre-trade transparent basis, subject to exceptions;
 - (b) equity market operators to make available specified pre-trade and post-trade information;
 - (c) equity market participants that execute transactions off-order book in reliance on the pre-trade transparency exceptions to report their trades to an equity market operator; and
 - (d) equity market participants that operate crossing systems to report specified information to ASIC.
- 59 In CP 179, we proposed amending Chapters 4 and 5 of the competition market integrity rules to:
- (a) alter the block trade thresholds;
 - (b) require price improvement for off-order book trades below block size;
 - (c) specifically require market operators to validate trade reports against the pre-trade transparency exceptions; and
 - (d) specifically require market participants to keep records in relation to pre-trade transparency exceptions.
- 60 The rationale for, and operation of, these existing and proposed pre- and post-trade transparency obligations is set out more fully in Sections D and F of draft amended RG 223 at Attachment 2 to CP 179. We consider that this rationale applies to CGS depository interests with some modifications.
- 61 Pre-trade transparency obligations for CGS depository interests without any exceptions could arguably ensure retail investors have a more visible pricing benchmark for investments in corporate bonds they may wish to make.
- 62 However, we consider that it is important to foster the involvement of wholesale interest in CGS depository interests alongside retail interest. For this reason we propose to allow for the full suite of pre-trade transparency exceptions that apply to equity market products to also apply to CGS depository interests, with necessary modifications. This could help ensure better liquidity for these products and could also ensure that retail bid–ask spreads are not unreasonably wide relative to wholesale spreads, by permitting wholesale dealers acting as arbitrageurs to put competitive pressure on market makers.

G Regulatory data for market surveillance

Key points

Our proposals extend the scope of the regulatory data regime in Chapter 5A of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests.

Chapter 5A of the competition market integrity rules

Proposal

G1 We propose to extend draft Chapter 5A of the competition market integrity rules (as proposed in CP 179) to CGS market operators and CGS market participants in relation to orders and transactions in CGS depository interests.

We will also take into account any amendments to draft Chapter 5A following on from CP 179.

See draft Chapter 5A of the competition market integrity rules.

Your feedback

- G1Q1 Do you agree with our proposal to apply the regulatory data regime in Chapter 5A of the competition market integrity rules to CGS depository interests?
- G1Q2 Should the required regulatory data be more closely tailored to suit CGS depository interests? If so, how?
- G1Q3 What is the likely impact of our proposals? What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?
- G1Q4 To what extent should the regulatory data proposals be applied to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

Rationale

- 63 In CP 179 we proposed a draft Chapter 5A of the competition market integrity rules requiring:
- (a) an equity market participant dealing in ASX-quoted products (excluding futures and options) to provide ASIC with additional data on orders to assist in its regulatory surveillance function; and
 - (b) an equity market operator to provide ASIC with the regulatory data received from market participants.

- 64 The rationale for, and operation of, the proposed regulatory data regime for equity market products is set out more fully in Section H of draft amended RG 223 at Attachment 2 to CP 179. We consider that this rationale applies equally to CGS depository interests traded on public exchanges.

H Market operators: Other obligations

Key points

Our proposals extend the scope of the other market operator obligations in Chapter 6 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests.

We propose a single tick size of \$0.001 for CGS depository interests.

Chapter 6 of the competition market integrity rules

Proposal

- H1 We propose to extend Chapter 6 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS market operators, except that:
- (a) we propose that, where there is more than one CGS market operator, we will determine who is the responsible CGS market operator (and therefore the operator responsible for assigning each CGS depository interest a unique symbol to be used by all CGS market operators to identify that CGS depository interest in records of orders, transactions and other trading messages);
 - (b) we will require single standard tick sizes of \$0.001 for CGS depository interests, in line with existing tick sizes for debt market products traded on both ASX and NSXA.

See draft amended Chapter 6 of the competition market integrity rules.

Your feedback

- H1Q1 Do you agree with our proposal to apply the market operators regime in Chapter 6 of the competition market integrity rules to CGS depository interests?
- H1Q2 Do you agree with the approach of a minimum incremental tick size of \$0.001 for CGS depository interests?
- H1Q3 Do you agree coordinated trading halts should apply to CGS depository interests? If not, why not?
- H1Q4 What is the likely impact of our proposals? What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?
- H1Q5 To what extent should the market operator regime proposals be applied to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

Rationale

- 65 Chapter 6 of the competition market integrity rules currently requires equity market operators to cooperate and share information, use common symbols, identifiers and tick sizes, synchronise the clocks they use for their trading, supervision and reporting systems to the UTC(AUS) maintained by the National Measurement Institute (NMI), and notify ASIC of changes to their procedures.
- 66 The rationale for, and operation of, these obligations is set out more fully in Section I of draft amended RG 223 at Attachment 2 to CP 179. We consider that this rationale applies equally to CGS depository interests traded on public exchanges.
- 67 If there are not multiple public exchanges offering retail trading in CGS depository interests, many of these obligations will not apply or be of minimal impact.

I Market participants: Other obligations

Key points

Our proposals extend the scope of the Market Participants regime in Chapter 7 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS depository interests.

Chapter 7 of the competition market integrity rules

Proposal

- 11 We propose to extend Chapter 7 of the competition market integrity rules (as proposed to be amended in CP 179) to CGS market participants.

See draft amended Chapter 7 of the competition market integrity rules.

Your feedback

- I1Q1 Do you agree with our proposal to apply the market participants regime in Chapter 7 of the competition market integrity rules to CGS depository interests?
- I1Q2 Do you agree that trading in all CGS depository interests should stop during a trading market integrity halt or suspension?
- I1Q3 Is specifying the volume-weighted average price (VWAP) for CGS depository interests an appropriate method for single trade confirmation? If not, why not?
- I1Q4 What is the likely impact of our proposals? What would be the cost (in terms of market integrity or investor confidence) of not adopting our proposals?
- I1Q5 To what extent should the market operator regime proposals be applied to other retail debt market products (including corporate bonds) that are or may be traded on public exchanges?

Rationale

68 Chapter 7 of the competition market integrity rules currently requires market participants to transact under the operating rules of a market operator in equity market products and prohibits off-order book trading where there is a market integrity-related trading suspension across equity markets. Part 7.3 of those rules also permits market participants to give clients a single trade confirmation where their orders are executed across multiple public exchanges.

69 The rationale for, and operation of, these obligations is set out more fully in Section J of draft amended RG 223 at Attachment 2 to CP 179.

J Regulatory and financial impact

- 70 In developing the proposals in this paper, we have carefully considered their regulatory and financial impact. On the information currently available to us we think they will strike an appropriate balance between:
- (a) protecting the integrity of the Australian financial markets; and
 - (b) avoiding duplication of regulatory obligations.
- 71 Before settling on a final policy, we will comply with the Australian Government's regulatory impact analysis (RIA) requirements by:
- (a) considering all feasible options, including examining the likely impacts of the range of alternative options which could meet our policy objectives;
 - (b) if regulatory options are under consideration, notifying the Office of Best Practice Regulation (OBPR);
 - (c) if our proposed option has more than minor or machinery impact on business or the not-for-profit sector, preparing a Regulation Impact Statement (RIS).
- 72 All RISs are submitted to the OBPR for approval before we make any final decision. Without an approved RIS, ASIC is unable to give relief or make any other form of regulation, including issuing a regulatory guide that contains regulation.
- 73 To ensure that we are in a position to properly complete any required RIS, we ask you to provide us with as much information as you can about our proposals or any alternative approaches including:
- (a) the likely compliance costs;
 - (b) the likely effect on competition; and
 - (c) other impacts, costs and benefits.

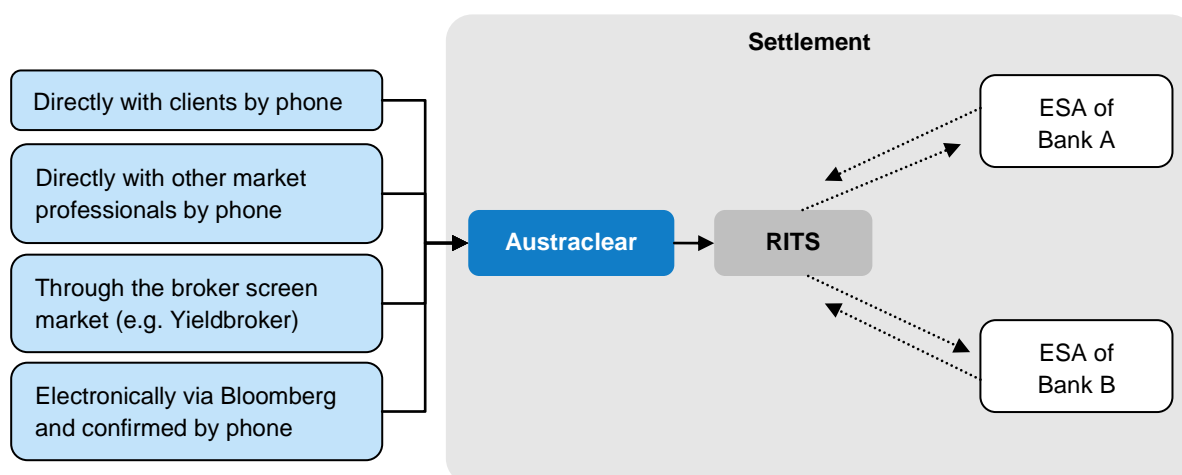
See 'The consultation process', p. 4.

Appendix: The CGS market in Australia and overseas

Trading in CGS on Australian markets

- 74 Trading in CGS in Australia predominantly takes place in the wholesale market—that is, on OTC or professional financial markets. Figure 1 provides an overview of trading in CGS on these markets.
- 75 The terms of the CGS trade are agreed directly among brokers or between brokers and clients (e.g. managed funds, corporates) by phone (OTC market) or via dedicated systems (professional financial markets). Instructions are then transmitted to the Austraclear securities settlement system. The transfer of securities in Austraclear occurs in real-time simultaneously with the settlement of resultant payment obligations between banks that represent Austraclear participants through the Reserve Bank Information and Transfer System (RITS) across the exchange settlement accounts (ESA) at the Reserve Bank of Australia (RBA).
- 76 Retail investors can trade CGS either through the facility provided by the RBA or intermediaries. However, direct retail participation in trading CGS on Australian markets has been limited.

Figure 1: Trading in CGS on OTC and professional financial markets



Sources: Australian Financial Markets Association (AFMA) debt capital market conventions;¹⁷ RBA.¹⁸

¹⁷ AFMA's debt capital market conventions are designed to streamline market practices and ensure trade at an accepted standard. A copy of the conventions can be found at www.afma.com.au/standards/conventions.html.

¹⁸ P Gallagher, J Gauntlett & D Sunner, 'Real-time gross settlement in Australia', *RBA Bulletin*, September 2010, www.rba.gov.au/publications/bulletin/2010/sep/8.html.

Current trading of CGS

- 77 CGS play an important role in the Australian financial market, including providing a benchmark against which other debt market products are valued. CGS offer minimal credit risk and are considered the proxy for pricing risk-free assets.
- 78 Over the last few years, the Government has increased the amount of Australian denominated CGS, with \$226.4 billion outstanding as at 30 April 2012, an increase of \$41.6 billion from the previous year.¹⁹ CGS are issued in a range of maturities and currently extend to bonds maturing in September 2030.²⁰
- 79 The market in CGS is very liquid and, as mentioned above, transactions take place predominantly among institutions, with few retail participants at present.
- 80 Trading occurs on a yield basis (rather than price) and intra-day and end-of-day CGS yields are widely available in the professional financial market. Average quoted yields at the end of each domestic trading day and market turnover figures are published daily in the *Australian Financial Review*. Turnover in CGS increased 59.8% over the 2010–11 financial year to \$1,483 billion.²¹
- 81 There is a strong inter-relationship between CGS and ASX 24 3-year and 10-year Treasury Bond futures. Many CGS OTC transactions are conducted on an exchange-for-physical basis (i.e. CGS are exchanged for the equivalent exposure in the bond contract) and this forms a solid base for price formation.
- 82 The OTC market for CGS consists of around 20 market makers²² (banks and investment banks) who transact with institutional investors directly or through approved licensed or exempt financial markets. Notwithstanding liquidity for CGS is currently concentrated off-exchange in the professional user only trading platforms, or OTC market, the proposals in this consultation paper only apply to market operators licensed to offer trading services in CGS depository interests to retail investors (i.e. on public exchanges) that enter into arrangements with AOFM, and participants of their markets that may deal in CGS depository interests.

¹⁹ AOFM, *Monthly changes in Commonwealth Government Securities (CGS) outstanding*, April 2012, www.aofm.gov.au/content/borrowing/commonwealth/Monthly_Changes_CGS/2012/04_april.asp.

²⁰ RBA, *Indicative mid rates of Commonwealth Government Securities: 2009 to current* (F16), live statistical table, accessed June 2012, <http://www.rba.gov.au/statistics/tables/xls/f16.xls>.

²¹ AFMA, *2011 Australian financial markets report*, report, 5 October 2011, http://www.afma.com.au/afmawr/_assets/main/lib90013/2011%20afmr.pdf.

²² Treasury Bonds are issued by competitive tender and there is an active secondary market. Active Treasury Bond market makers are listed at www.aofm.gov.au/content/investors/bonds.asp.

Current retail access to CGS

- 83 Australian Savings Bonds were issued by the Government between 1976 and 1987 and were targeted at the retail market. The high coupon rate and ease of redemption proved popular with retail investors and comprised 36% of total new government securities issued in 1986.²³
- 84 Since that period, retail access to CGS has been limited to two main options:
- (a) through the RBA—by submitting an application (transfer and acceptance form) to purchase or sell CGS to the RBA; and
 - (b) through brokers and other intermediaries—by dealing over the phone with firms who offer CGS to retail investors.
- 85 Figures indicate that retail investors have a low asset weighting to debt market products generally. Recent figures from the Australian Bureau of Statistics show that Australian households have in total \$2519.2 billion in assets, of which only \$4.5 billion consisted of bonds (or 0.18% per household). In comparison, households held in total \$668 billion in deposits (27% per household) and \$222.2 billion in equity (9% per household).²⁴
- 86 Retail investors in Australia have significantly higher weightings of equities in their portfolios than their Organisation for Economic Co-operation and Development (OECD) counterparts. The Government's initiative to facilitate the trading of CGS depository interests on public exchanges is expected to provide a more visible pricing benchmark and encourage retail investors to consider diversifying their savings via the debt market.
- 87 Retail take-up of CGS has been subdued for a number of reasons. Firstly, the decline of inflation and the reduction in interest rates since the early 1990s has meant that CGS yields were comparatively less attractive than equity returns. Strong growth in residential real estate prices in the 1990s and early 2000s drew a substantial share of household investment funds towards housing and away from other assets. The increased popularity of high-yielding term deposits in recent years and increased investment in cash management trusts prior to 2008 may have also limited retail demand for CGS.

Trading in CGS depository interests

- 88 The Government has announced that it will consider proposals for retail trading of CGS based on an 'indirect' or 'beneficial ownership' model.

²³ I Castles, *Year Book Australia 1986* (1301.0, No. 70), report, Australian Bureau of Statistics (ABS), 1 January 1986.

²⁴ B Pink, *Australian national accounts: Financial accounts* (5232.0, September 2011), report, ABS, 15 December 2011.

- 89 Currently, CGS transactions are settled in the wholesale market via Austraclear. Austraclear holds the legal title to the underlying CGS and a beneficial title is issued to wholesale security holders.
- 90 Beneficial ownership models for other financial products are also in place on public exchanges in the form of depository interests. Depository interests are a type of financial product that represents a beneficial interest in an underlying financial product to which the interest relates. On ASX, these are referred to as CHESSE Depository Interests (CDIs).²⁵
- 91 To date, CDIs are typically issued to facilitate a foreign company that lists on ASX quoting its securities,²⁶ or in circumstances where bearer securities (such as debt market products) are issued, or where the securities are held in a settlement and depository system other than CHESSE.²⁷
- 92 Hypothetically applying the CDI model to retail trading of CGS would involve two tiers of beneficial ownership:
- (a) Austraclear would continue to hold legal title to the CGS directly and issue beneficial interests in CGS to a nominee (similar to the way it operates currently to wholesale holders of CGS); and
 - (b) the nominee would issue further beneficial interests to retail investors, who would hold these beneficial interests in the form of CDIs in CHESSE.
- 93 There may be other depository interest models that would be suitable for retail trading of CGS, in particular those that may be offered by markets other than ASX.
- 94 AOFM has not yet announced which markets, if any, it will enter arrangements with for the trading of CGS depository interests.

Overseas retail markets in government bonds

- 95 Internationally, a number of countries operate facilities for retail trading of government bonds, with different underlying infrastructure and regulatory frameworks.
- 96 A number of retail government bond markets operate internationally. These are set out in Table 2.

²⁵ ASX, *CHESSE: Understanding CHESSE Depository Interests*, information brochure, 2009, http://www.asx.com.au/documents/products/chess_depository_interest.pdf.

²⁶ Where a foreign company (issuer) lists on ASX and the domestic laws of that foreign issuer do not recognise uncertificated holdings or electronic transfer of legal title, a type of CDI known as CHESSE Units of Foreign Securities (CUFS) may be issued for the purposes of trading, settling and holding the security on ASX.

²⁷ This type of CDI is typically issued as a security representing the beneficial interest in CHESSE.

Table 2: International government bond markets

United Kingdom	An electronic order-driven trading platform operates via the London Stock Exchange. This central order book provides ready access to debt market products for retail investors. Debt market products issued in the United Kingdom must be eligible for CREST settlement ²⁸ and be supported by an electronic market maker
Singapore	In 1997, a series of initiatives was launched to build the government debt market, resulting in the volume of outstanding corporate debt doubling in size while outstanding government debt increased sevenfold in the three years following that time. The Singapore Stock Exchange began offering retail services in government bonds on 8 July 2011
Italy	The Italian stock exchange, Borsa Italiana, manages two markets for the electronic trading of bonds and government securities accessible for retail investors: <ul style="list-style-type: none"> • MOT—a market facilitating trading in Italian and foreign government securities, corporate bonds for the domestic and international market, supranational securities and asset backed securities; and • ExtraMOT—a market for the corporate bonds of Italian and foreign issuers already admitted to trading on other regulated markets of the European Union
United States	Two broad classes of government debt securities are issued: marketable and non-marketable. All of the marketable securities are very liquid and are heavily traded on secondary markets such as the New York Stock Exchange (NYSE) Euronext. Non-marketable securities (such as savings bonds) are issued to subscribers and cannot be transferred through market sales. Retail investors can access US government bonds through full-service brokers, online brokerage, banks, the US Treasury's website and a form of salary deduction. ²⁹
Japan	Retail investors can buy or sell Japanese government bonds directly online or at various financial institutions such as banks, security companies and post offices

The Australian debt market

On-market and over the counter

97 Relative to the size of the Australian economy, the Australian debt market is around the average size for developed economies.³⁰ In contrast to many OECD economies, however, the private debt market is significantly larger than the

²⁸ CREST is the United Kingdom's securities settlement system, operated by Euroclear UK & Ireland, which since November 2001 has provided real-time Delivery versus Payment ultimately against central bank money for transactions in UK securities (gilts, equities and money market instruments):

see <http://www.bankofengland.co.uk/markets/Pages/paymentsystems/default.aspx>.

²⁹ US Census Bureau, *The 2012 Statistical Abstract: Banking, finance and insurance—Household financial assets and liabilities*, statistical tables, 2012,

http://www.census.gov/compendia/statab/cats/banking_finance_insurance/household_financial_assets_and_liabilities.html.

In 2010, American households held US\$4,235 billion worth of debt securities (or 8.9% of assets per household), of which a little over half consisted of various types of government bonds. The size of the government debt market in the United States has also led to the creation of specialised bond trading platforms, which offer retail access.

³⁰ G DeBelle, 'The Australian bond market in 2011 and beyond', Speech by the Assistant Governor (Financial Markets) of the RBA, KangaNews Australian DCM Summit, Sydney, 15 March 2011.

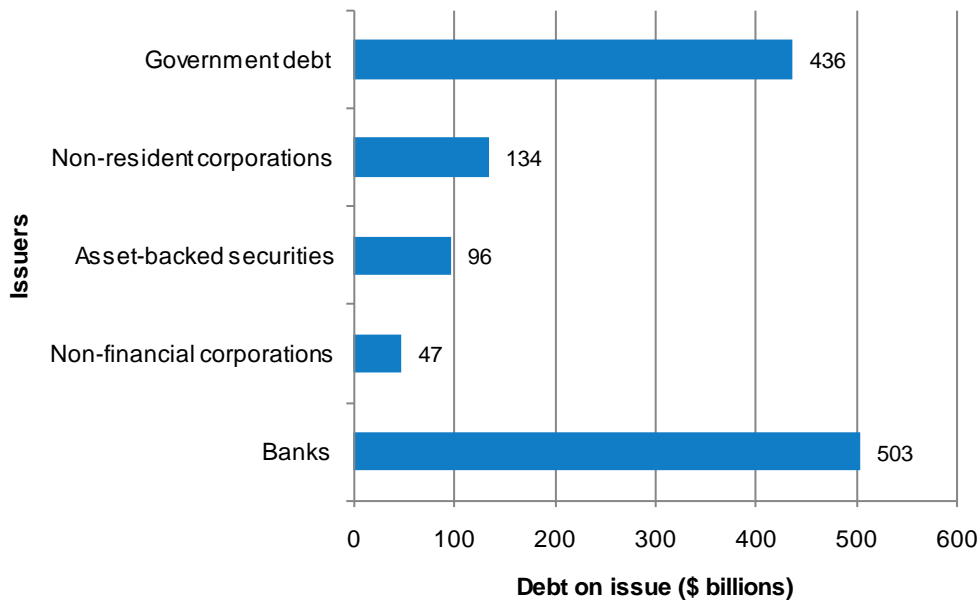
public market. The relative sizes of the Australian public and private debt markets are shown in Figure 2.

98 Figure 2 illustrates that non-government bonds are the predominant type of debt in the Australian market. Indeed, wholesale debt markets have come to be a significant source of funding for credit growth in the Australian market. This non-government debt can be categorised into four types of issuers, set out in Table 3.

Table 3: Non-government debt issuers

Authorised deposit-taking institutions (ADIs)	ADIs are relatively large debt issuers as they rely on deposits and wholesale funding to finance lending including mortgage lending
Non-ADI financial institutions	Non-ADI financial institutions issue asset-backed securities as a significant source of debt on issue. For non-ADI financial institutions, asset-backed securities are a significant source of funding. Through the AOFM, the Government supported the issue of certain kinds of asset-backed securities after the onset of the global financial crisis in 2008.
Foreign corporations	Strong demand for Australian dollar assets has seen a rapid increase in the issue of Australian-dollar debt by foreign corporations. Much of this was traditionally offshore in the Eurobond market, but increasingly it has moved to the onshore 'kangaroo' market
Locally incorporated business	Local business continues to be a major source of debt issued in the wholesale market. This allows financing of their business requirements

99 Figure 2 shows the debt outstanding by each of these non-government issuers. Banks are clearly the largest private issuers of debt but there is also a large issue of asset-backed securities and debt by non-resident corporations.

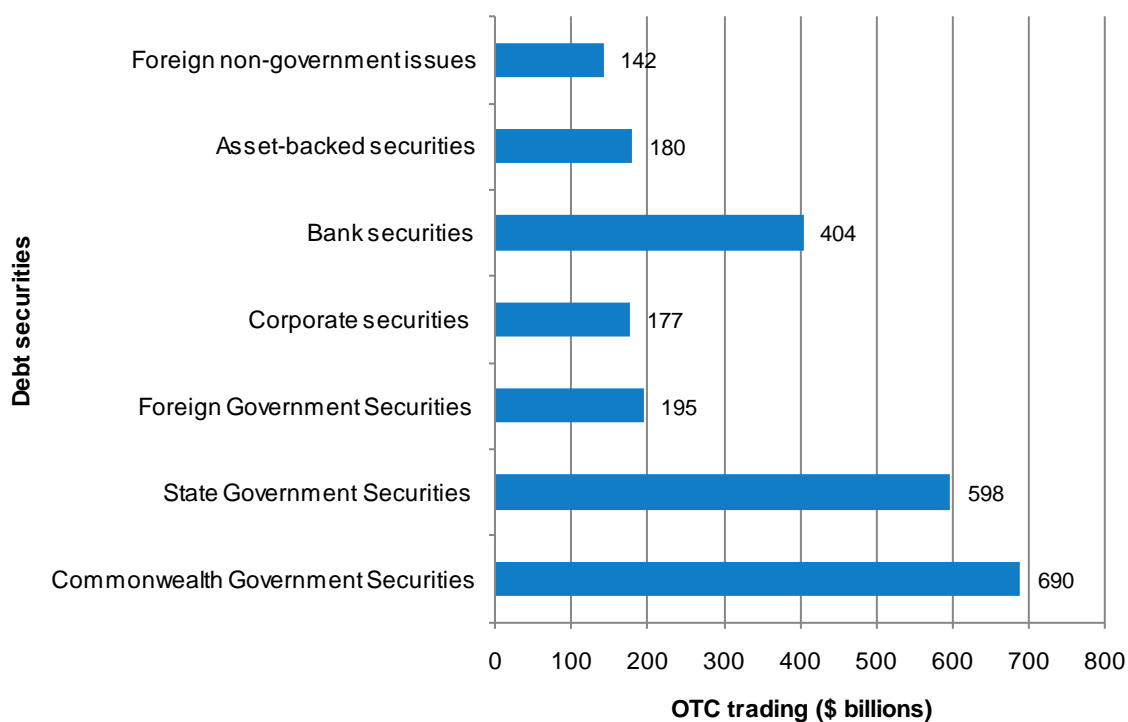
Figure 2: Debt on issue in Australian markets for May 2012

Source: RBA.³¹

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The vast majority of debt securities in Australia are traded over the counter and relatively few securities are traded on the listed market. Information on the trading of debt instruments on the OTC market is shown in Figure 3. Trading in debt securities is dominated by Government issues, and trading volumes are higher than those for other types of securities given the relative amounts on issue.

³¹ RBA, *Debt securities outstanding (D4)*, live statistical table, accessed February 2012, <http://www.rba.gov.au/statistics/tables/xls/d04hist.xls>.

Figure 3: OTC trading of debt securities for 2010–2011 financial year

Source: AFMA.³²

Trading of debt on public exchanges

- 101 CGS products fall into a broad class of assets that provide investors with a predictable cash flow (e.g. fixed coupons) that is paid on a periodic basis, with a specified maturity date. These are sometimes referred to in the market as fixed income products, debt market products, bonds, or interest rate securities. The products in this broad asset class, whether issued by a government or body, are generally ‘financial products’ under Ch 7 of the Corporations Act.
- 102 Corporate debt currently trades on public exchanges. The public exchanges operated by ASX and NSXA currently offer trading services in this broad asset class. ASX offers trading in ‘interest rate securities’ (including corporate bonds, floating rate notes, convertible notes and hybrid securities) through its ASX Trade trading platform. NSXA offers trading in ‘debt securities’ through its NSX Electronic Trading System. These are subject to existing market integrity rules and operating rules that apply to trading of cash market products and debt securities on ASX and NSXA markets, respectively.

³² AFMA, *2011 Australian financial markets report, report*, 5 October 2011, http://www.afma.com.au/afmawr/_assets/main/lib90013/2011%20afmr.pdf.

Key terms

Term	Meaning in this document
ADI	Authorised deposit-taking institution
AFMA	Australian Financial Markets Association
AOFM	Australian Office of Financial Management
ASIC	Australian Securities and Investments Commission
ASX	ASX Limited (ACN 008 624 691) or the exchange market operated by ASX Limited
Austraclear	The electronic registry and settlement system for government, semi-government and private sector debt securities.
Australian market licence	Australian market licence under s795B of the Corporations Act that authorises a person to operate a financial market
CDI (CHESS Depository Interest)	An instrument used by non-Australian companies to support electronic registration, transfer and settlement of their products listed on ASX
CGS (Commonwealth Government Securities)	Means all securities issued by the Australian Government, comprising Treasury Bonds, Treasury Notes, Treasury Indexed Bonds and, previously, Treasury Adjustable Rate Bonds. These securities are issued either by tender or syndication
CGS depository interest	A depository interest in a class of CGS
CGS market	A market in CGS depository interests operated by a CGS market operator.
CGS market operators	A market operator of a public exchange that has entered into arrangements with AOFM to offer trading in CGS depository interests
CGS market participant	A market participants that trades in CGS depository interests on a CGS market
CHESS	Clearing House Electronic Subregister System
competition market integrity rules	ASIC Market Integrity Rules (Competition in Exchange Markets) 2011—rules made by ASIC under s798G of the Corporations Act that are common to markets dealing in equity market products quoted on ASX
Corporations Act	<i>Corporations Act 2001</i> , including regulations made for the purposes of that Act
CP 168 (for example)	An ASIC consultation paper (in this example, numbered 168)

Term	Meaning in this document
debt market product	Any one of a broad asset class (including corporate bonds, floating rate notes, convertible notes and hybrid securities) that provides investors with a predictable cash flow (fixed or floating coupons) which is paid on a periodic basis, with a specified maturity date
depository interest	A financial product quoted on a market that confers on the holder a beneficial interest in another financial product (the underlying) to which it relates, where legal title to the underlying is held by a nominee company on behalf of the holder
ESA	Exchange settlement account
financial market	As defined in s767A of the Corporations Act. It encompasses facilities through which offers to acquire or dispose of financial products are regularly made or accepted
financial product	<p>Generally a facility through which, or through the acquisition of which, a person does one or more of the following:</p> <ul style="list-style-type: none"> • makes a financial investment (see s763B); • manages financial risk (see s763C); and • makes non-cash payments (see s763D) <p>Note: See Div 3 of Pt 7.1 of the Corporations Act for the exact definition.</p>
Government	Australian Government
market operator	A holder of an Australian market licence that is the operator of a financial market on which equity market products are quoted
market participant	An entity that is a participant of a financial market on which equity market products are quoted
NMI	The National Measurement Institute division of the Commonwealth Department of Innovation, Industry, Science and Research
NSXA	The market known as the National Stock Exchange of Australia, operated by National Stock Exchange of Australia Limited
OECD	Organisation for Economic Co-operation and Development
order book	An electronic list of buy orders and sell orders, maintained by or on behalf of a market operator, on which those orders are matched with other orders in the same list
OTC	Over-the-counter

Term	Meaning in this document
Part 2.1 (Competition) (for example)	A part of the competition market integrity rules (in this example numbered 2.1)
professional financial market	A market where market users are professional investors (as defined in the Corporations Act) and participate in the market platform on their own behalf or on behalf of other professional investors
public exchange	An Australian domestic licensed financial market through which participants provide services for retail investors (i.e. a licensed financial market with approved compensation arrangements under Pt 7.5 of the Corporations Act)
RBA	Reserve Bank of Australia
Request for Proposals	'Request for Proposals: Trading of Commonwealth Government Securities on financial markets in Australia', issued by AOFM on 1 November 2011
retail investor	A retail client as defined in s761G of the Corporations Act
RITS	Reserve Bank Information and Transfer System
RG 223 (for example)	An ASIC regulatory guide (in this example numbered 223)
Rule 1.4.2 (Competition) (for example)	A rule of the competition market integrity rules (in this example numbered 1.4.3)
s795B(1)	A section of the Corporations Act (in this example numbered 765B(1))
UTC(AUS)	The output of the caesium atomic clock designated by the NMI as UTC(AUS)