

12 December 2002

Commonwealth Debt Management Review
Department of the Treasury
Langton Crescent
PARKES ACT 2600
By e-mail: debtreview@treasury.gov.au

Dear Sir/Madam

Thank you for the opportunity to comment on the future of the Commonwealth Government Securities (CGS) market.

Credit Union Services Corporation (Australia) Limited (CUSCAL) is the main industry body for credit unions. CUSCAL is an Authorised Deposit-taking Institution (ADI) providing banking and other commercial services and industry association services to 173 of Australia's 196 credit unions. CUSCAL is owned by its affiliated credit unions.

Credit unions are mutual ADIs, owned by their customers, providing a range of services in the retail banking market. Credit unions have 3.5 million members and total assets of \$25.7 billion. Credit union members have \$21.8 billion on deposit with their credit unions.

All ADIs are required to maintain an adequate stock of high quality liquid assets to cater for any unexpected liquidity pressures or fluctuations under both normal and adverse operating conditions.

CUSCAL is the custodian of the credit union industry's liquid funds. CUSCAL invests only in prime investment grade securities with little or no credit risk and matches a high percentage of its liabilities with assets of like maturity, thereby minimising interest rate risk. CUSCAL has a conservative treasury philosophy, it is not a position taker, and each investment is to earn a market or near market return.

CUSCAL currently manages around \$3.5 billion in credit union funds. CUSCAL provides banking and investment services for credit unions and maintains an Exchange Settlement Account with the Reserve Bank of Australia. CUSCAL's products include overnight deposits, fixed and floating rate deposits, pooled investment funds, derivative facilities, forward deposits, and overdraft, standby and medium term loan facilities.

Guidance Note 210.3 to APRA's Prudential Standard on Liquidity says: "In assessing whether a particular asset is acceptable for the purpose of the minimum liquidity

holdings requirements, APRA will have regard to the marketability and credit quality of the asset. This includes whether there is an established secondary market in which the particular asset can be readily sold, as well as the size of the ADI's holding of that asset relative to the ADI's liquid holding portfolio and to the total volume of the asset on issue. As a minimum the asset must be free from encumbrances and be readily convertible into cash (Australian dollars if the asset is denominated in foreign currency) within two business days."

Commonwealth Government Securities are high quality liquid assets free of credit risk.

Among the roles of CGS identified in the CGS market review discussion paper, CUSCAL is most concerned about whether substitute securities could:

- provide a safe haven in times of financial instability;
- facilitate management of financial risk; and
- assist the pricing and referencing of financial products.

CUSCAL seeks the Government's assurance that these critical roles can be performed by other securities.

Will current or new issuers assume the benchmark role in the domestic market, or will issuers increasingly turn to offshore markets?

According to the Reserve Bank¹, non-government bonds on issue increased rapidly in the last decade to the point where the total \$ amount is around the same size as the combined outstandings of the Commonwealth and State governments.

However, the volume of bonds issued offshore by the non-government sector has increased just as quickly and this market segment is now 80 percent larger than the domestic market.

If the Government does choose to wind down the CGS market, Australia will be the first country in the world to take this step. As we move into these "uncharted waters"² CUSCAL looks forward to the Government's assurances that the private sector is capable of undertaking the roles performed by the CGS market.

Yours sincerely

LUKE LAWLER
Senior Adviser, Policy and Public Affairs
02 6232 6666
llawler@cuscal.com.au

¹ *Why do so many Australian borrowers issue bonds offshore?* Ric Battelino, RBA Assistant Governor, 26 November 2002.

² RBA Governor Ian Macfarlane, Parliamentary Committee Hearing, 6 December 2002.